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## **DEVELOPMENTAL STATES IN THE FACE OF GLOBALIZATION: SOUTHEAST ASIA IN COMPARATIVE EAST ASIAN PERSPECTIVE**

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Part of the debate over the East Asian miracle has focused on the role of the so-called 'developmental state'. This paper focuses on three Southeast Asian economies, namely, Malaysia, Indonesia and Thailand (MIT economies) once dubbed high performing Asian economies (HPAEs) before the 1997-98 East Asian financial crises. It is assumed that the central feature distinguishing developmental states is its pursuit of industrial policy, i.e. the selective promotion of certain economic activities, usually through state interventions, but often involving indirect means such as official endorsement or pro-active responsiveness to collective private sector initiatives. Arguably, industrial policy has been the main feature of the emergence and transformation of capitalism in most parts of the world.

The rapid growth of East Asia and East Asian capitalism as part of a flock of flying geese following Japan, implied a coherent region more than it actually is, and a corresponding tendency to see economic progress in the region as similar in origin and nature leading to terms such as the 'Far East', 'Asia-Pacific', 'Pacific Asia', 'East Asia', 'yen bloc', 'flying geese', 'tigers', 'mini-dragons' and so on. According to some (e.g. Yoshihara 1988), the fast growing Southeast Asian economies have been characterized by ersatz capitalism because of the compromised and inferior role of their states, their treatment of ethnic Chinese and their failure to develop better technological capabilities. The World Bank (1993) argued that the Southeast Asian high performing economies were the preferable model for emulation by other countries seeking late development. Jomo K. S. *et al.* (1997) criticize the World Bank's claims, suggesting instead various problems associated with the growth experiences of the very economies praised by the Bank. In any case, the East Asian currency and financial crises of 1997-98 radically transformed international opinion about the Southeast Asian capitalist models, with praise quickly transformed into condemnation as in Jomo (1998).

The MIT economies as second-tier or second-generation newly industrializing economies (NIEs) share some common characteristics with Singapore, which is also in the region. However, they are not only far less advanced in developmental terms, but also quite different from the city-state's heavy reliance on trade and financial services besides manufacturing. Essentially, this paper reviews how Southeast Asia in general, and the MIT economies in particular, are somewhat different in their developmental states and industrial policies compared to the rest of the first-generation NIEs. Although Singapore too has pursued industrial policy, it has used fewer trade policy instruments and has been far more reliant on foreign direct investment. Though Singapore, like Hong Kong, has eschewed trade policy instruments, it has used state-owned enterprises (SOEs) (usually referred to as government-linked corporations (GLCs) in the island republic) more than any other East Asian economy, and perhaps any other economy in the world, barring Israel and Italy, in the early 21<sup>st</sup> century.

Most importantly, the Southeast Asian high growth economies (including Singapore) have relied much more heavily on foreign direct investment (FDI) to develop most of their internationally competitive industrial capabilities. Trade policy instruments in the region have been less well formulated and implemented, with rather mixed consequences, but have nonetheless been part of the region's industrial policy story.

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Generally, government interventions in the region have been influenced by a variety of considerations besides economic development and late industrialization. Consequently, industrial policy has also varied in nature, quality and effectiveness. Yet, it will be shown that the economies in the region would not have achieved as much as they have without selective government interventions, including industrial policy.

The next section starts with a critical review of the World Bank's (1993) influential study of the East Asian economic miracle, especially its treatment of industrial policy. The following section emphasizes the diversity of East Asian experiences and the significance of recognizing this diversity for drawing appropriate lessons. The fourth section stresses the inferiority of the Southeast Asian experiences – compared to their other East Asian counterparts. The fifth section advances the critique of Southeast Asian industrialization, while the sixth section extends the critique to other aspects besides industrialization. The seventh section elaborates on the 1997-98 Southeast Asian currency and financial crises, which ended the Southeast Asian miracle. The concluding part identifies some new challenges for a contemporary developmental state, particularly in terms of industrial policy options available.

### **The World Bank and the 'East Asian Miracle'**

The World Bank's *East Asian Miracle* (1993) identified at least six types of state interventions. It approved of the first four, deemed functional interventions, namely: a) ensuring *macroeconomic* discipline and macroeconomic balances, b) providing physical and social *infrastructure*, c) providing good *governance* more generally, and d) raising *savings* and investment rates. Functional interventions were said to compensate for market failures, and hence were deemed desirable and less distortive of markets, while the latter two were considered to be strategic interventions, more market-distortive. The two types of strategic interventions considered were in the areas of finance, specifically what it calls directed (i.e. subsidized) credit, and industrial policy.

The functional interventions were not just market conforming, but instead played important pro-active roles which have been more than simply market augmenting, as suggested by the World Bank analysis. On the more controversial strategic interventions in finance and industrial policy, the Bank conceded that financial interventions were important and successful in East Asia, particularly in Northeast Asia — i.e. in Japan, Korea and Taiwan. However, the Bank implied that other developing country governments were not capable of successfully pursuing the types of policies that the Northeast Asians successfully implemented because state capabilities in Northeast Asia have been almost unique and are virtually non-replicable.

The Bank's volume's evaluation of the role and record of Japan's Ministry of International Trade and Industry (MITI) and its counterparts elsewhere in the region is more predictable, arguing that government interventions have been trade-distortive and, more importantly, generally unsuccessful in East Asia, although export promotion in particular comes in for much praise. While the Bank approves of export promotion, it disapproves of import protection, but fails to see the connection between the two. The Japanese, South Korean and Taiwanese governments implemented import substituting industrialization (ISI) policies from the fifties, but also pursued export-promotion *as well* to ensure that their industries quickly become internationally competitive by requiring a rapid transition from import substitution to export-orientation, termed 'effective protection conditional on export promotion' (EPconEP). It is quite different from just import-substitution or export-promotion as in export-processing zones (EPZs). Both import-substitution and export-promotion (e.g. subsidies) are trade distortions, though the Bank only disapproves of the former, not the latter. It is also misleading to suggest that

EPconEP is tantamount to a ‘simulated free trade’ regime because the ‘bad’ import protection distortion is negated by the ‘good’ export promotion distortion. EPconEP allows industries and firms to enjoy rents from import protection to develop the industrial and technological capabilities in order to become internationally competitive in terms of both cost and quality.

Infant industries have often been provided with effective protection conditional on export promotion, which has had the effect of forcing the firms and industries concerned to quickly become internationally competitive. By giving firms protection for certain periods, depending on the product, and by also requiring that they begin exporting certain shares of output within similarly specified periods, strict discipline was imposed on the firms in return for the temporary trade protection they enjoyed. In order to become internationally competitive, such policies forced firms to reduce their unit production costs as quickly as possible, e.g. by trying to achieve greater economies of scale and accelerating progress up learning curves. Requiring exports has also meant that producers have had to achieve international quality standards quickly, which imposed pressures to progress technologically in terms of product design and quality as well as technological processes. With strict discipline imposed, but also some flexibility in enforcement, many of these firms managed to rapidly achieve international competitiveness.

### **Diversity**

Some important differences among the East Asian economies suggest that not all East Asian miracle economies have been proceeding inexorably in the same direction in a similar manner. Although the Bank does not really tout an East Asian model as such, the Bank study has often been read as distinguishing between the two variants noted above. From East Asia in the singular, as generic East Asian models, the financial crisis since mid-1997, has led to similar broad-brushed sweeping generalizations about East Asian ‘crony capitalism’.

The East Asian experiences are far from constituting a single model. Some of the major differences in East Asia are themselves very instructive. In the case of the role of FDI, tremendous contrasts are found. In the case of Singapore, FDI has constituted about a quarter of gross domestic capital formation and about 15 per cent in Malaysia. At the other end of the spectrum, in the case of Japan and Korea, the percentage has long been below two per cent. Some of the other countries fall between these two extremes, with very few near the mean for developing countries of around five per cent. Those most successful in developing industrial capacities and capabilities in East Asia — namely Japan, South Korea and Taiwan — have hardly depended on FDI, which has only played a relatively small role.

FDI’s far greater importance in Southeast Asia has been due to a variety of reasons, which have not been entirely economic. One of the reasons for the major role of FDI in Singapore and Malaysia is political. After Singapore seceded from Malaysia in 1965, the regime decided that to ensure its own survival, it would be best to attract FDI massive quantities, so that the major foreign powers would quickly develop a stake in the survival of the Singapore regime. Subsequently, of course, this preference has been justified in terms of improving access to the technology frontier. In other words, political considerations have been a very important reason for attracting, even privileging foreign investment in Singapore.

Malaysia has long had ethnic rivalries and an ethnic affirmative action policy. This has encouraged some policy-makers to try to limit ethnic Chinese control of the economy by encouraging foreign direct investment so that the proportion of ethnic Chinese control of the economy would be correspondingly reduced. Again, one finds a

political motivation for the important role of FDI in Malaysia. Singapore and Malaysia are, in some sense, exceptions, and these exceptions need to be explained politically, rather than simply by economic considerations.

There has also been considerable diversity in the role and performance of public investments, including SOEs, in East Asia, including within Southeast Asia. In South Korea, Japan and, of course, Hong Kong, SOEs are hardly important today, but historically, state-owned enterprises were important in Japan at the end of the last century and early this century, before the Second World War. Conversely, however, one finds that state-owned enterprises have been extremely important in Singapore and Taiwan more recently. Again, this is partly explained by political factors, but there are also economic considerations. And very importantly, the performance of these SOEs has also been quite impressive.

Industrial and technology policies in East Asia have also been quite diverse. One extreme, of course, is Hong Kong, where there is relatively little industrial policy, although more than most opponents of industrial policy care to admit. It is far more detailed and sophisticated in Japan and Korea at the other end of the spectrum. In Korea, industrial policy is largely oriented towards large firms, whereas in Taiwan, much more emphasis is given to medium and relatively smaller enterprises.

Industrial policies in the region have also had different orientations, emphases and instruments. For example, the role of trade policy has been very important in almost all economies in the region except Hong Kong and Singapore, while financial policy has been important in all the countries, including Singapore, but again, with the exception of Hong Kong. Since Hong Kong's reversion to China in mid-1997, there have been many indications of the likely introduction of industrial policy for the territory, presumably in line with its new status and China's envisaged role for the de-industrialized financial centre. There have also been very important differences in the role of technology policy in the region.

The World Bank recommended that the rest of the developing world emulate Southeast Asia, not Northeast Asia because of important differences between Northeast Asia and Southeast Asia underlying the Bank's recommendations. These differences require us to recognize the achievement of the first-tier East Asian NIEs (including Singapore) — rather than the transformation of the second-tier Southeast Asian NIEs — as far more impressive and superior in terms of economic performance.

Growth performance has been superior in Northeast Asia over the long term despite the much greater resource wealth of Southeast Asia. Over the period studied by the Bank, i.e. from the sixties until the early nineties, the average growth rate in the former was in the region of about eight per cent, compared to about six per cent for the latter. A two per cent difference, compounded over a period of a quarter century or more, adds up to a lot. Very importantly, except in Hong Kong (due to immigration from China) and perhaps Singapore, population growth has been much lower in the former compared to the latter. The immigration into Hong Kong and Singapore involves a very high proportion of people in the labour force, thus raising the average labour utilization rate. Political factors have also ensured far more equitable distribution of economic welfare than would otherwise have been the case in the first-tier NIEs, whereas such considerations have been less influential in the second-tier Southeast Asian NIEs except perhaps for Malaysia, owing to its ethnic 'social contact'.

Improvements in per capita income and economic welfare have been much more significant in Northeast Asia, compared to Southeast Asia (with the exception of Singapore), despite the relative resource wealth of the latter. Income inequalities have also been far less in Northeast Asia, although there is evidence of rapid recent increases in

inequality. In other words, what Southeast Asia has achieved has been less impressive in some critical ways. Drawing from this contrast, some people now argue that resource wealth is not a blessing, but a curse, in so far as it postpones the imperative to industrialize.

This paper has maintained that Northeast Asia has generally had much more sophisticated and effective industrial policy compared to Southeast Asia. This accounts, in no small way, for the very important differences in industrial and technological capabilities between Northeast Asia and Southeast Asia. Also, Southeast Asian industrialization is still driven by FDI, whereas Northeast Asian industrialization is primarily an indigenous phenomenon.

Japan and the first-generation NIEs began to industrialize in the very specific economic and political conditions of a particular Cold War historical conjuncture. Northeast Asia grew rapidly in the immediate post-war period under a ‘security umbrella’ provided by the Americans, especially after the Cold War began. Besides subsidizing military expenditure and providing generous aid, the Americans were anxious for them to ‘succeed’ economically in order to be showcased as attractive alternatives to those under communist rule or influence. Hence, the Americans were quite happy to tolerate trade, finance, investment, intellectual property and other policies violating *laissez faire* market or neo-liberal economic norms that they are now strongly opposed to, especially with the end of the Cold War. Such conditions are simply not available to others, and hence, their experiences are said to be almost impossible to emulate. To discourage other developing countries from trying to emulate the first-generation East Asian NIEs, it is now often argued that their state capabilities have been almost unique and it is virtually impossible for any other governments to successfully emulate them. The more cultural explanations suggest that this has something to do with the East Asian Confucian legacy of meritocracy.

The Guomindang government of Taiwan was the same regime driven out of mainland China by the communists because of its incredible incompetence and corruption. One could say the same of the Rhee regime in Korea in the fifties as well as the Chun and Roh regimes in the eighties. Japan has hardly been scandal-free in recent years and most observers would trace recently disclosed abuses to the nature of post-war Japanese political economy. The superior policy-making and implementation capabilities of the Northeast Asian decision makers was, at least until recently, widely acknowledged, but this, in itself, does not prove the existence of thoroughly competent and incorruptible policy makers.

Some also claim that East Asia cannot be emulated owing to its very different initial conditions. Such differences are real, but often exaggerated. There is no doubt that Japan as well as the first-tier East Asian NIEs have also been distinguished by much higher levels of educational achievement. However, the level of literacy in Korea in 1950 was lower than the literacy rate in contemporary Ethiopia, which has one of the lowest literacy rates in Africa today. The level of education achieved by contemporary South Koreans reflects the tremendous investments put into developing human resources in East Asia in the post-war period as East Asia was not generally that far ahead in the immediate post-war period despite, or perhaps even because of its (elitist) Confucian legacy. But by the end of the 1960s, literacy rates had gone up tremendously for the first generation East Asian NIEs.

Some fortuitous circumstances must also be considered. Japan, South Korea and Taiwan all had relatively virtuous American-sponsored land reforms soon after the end of the war. In Japan, there also was significant redistribution of other non-land assets, most notably, of the pre-war and wartime *zaibatsu* industrial conglomerates. Much of the

motivation for such redistributive reforms was, of course, anti-communist, i.e. to undermine and minimize support for the communists by those desiring asset redistribution.

More egalitarian asset redistribution in Japan, South Korea, Taiwan and China have also been important, in contrast to Southeast Asia. Ironically, the Americans were not uninfluenced by the left, partly because of the nature of the wartime anti-Axis alliance and the nature of the most influential scholarship available. During the post-war American occupation of Japan, it was widely presumed that the *zaibatsu* ‘military industrial complex’ had been responsible for the militarization of pre-war Japan. So the Americans decided to dismantle the *zaibatsu*, and forcibly broke family control of the *zaibatsu*, selling off the assets in interesting ways with important consequences. To ensure popular acceptance of this policy, first preference was given to employees, and then to local communities, thus developing worker and community stakes in the companies and the basis for what is now called a stakeholder economy.

Hence, the so-called stakeholder economy of Northeast Asia was created by deliberately redistributive policies that have had many outcomes now considered to be peculiarly Japanese. Similarly, many now acknowledge the influence of the ‘human relations’ school of industrial relations on the post-war development of guaranteed life-long employment and the seniority wage system, both of which have effectively developed a strong employee commitment to the fate of their firm. There are many other ostensibly peculiarly Japanese features. Many of these were not features inherited from the Edo period or even developed autochthonously during the Meiji period. Quite a few are actually relatively recent innovations, with rather virtuous consequences.

### **Why Not Southeast Asia?**

The MIT economies’ industrialization records (Jomo *et al.* 1997; Jomo 2001) have been significantly different from and inferior to those of the other HPAEs, especially Japan, South Korea and Taiwan, as well as Singapore. First, the experiences of the MIT economies as well as Hong Kong and Singapore more closely approximate the export-led growth model than those of Japan, South Korea and Taiwan as noted above. The latter appear to have promoted exports very actively while also protecting domestic markets, at least temporarily, to develop domestic industrial and technological capabilities in order to compete internationally under which can hardly be equated with trade liberalization. Recent neo-liberal criticisms (Baer, Miles and Moran, 1999) of attempts by an earlier generation (e.g. Little, 1981 and Krueger, 1974) to accommodate the Northeast Asian EPconEP experience within their fundamentalist free trade advocacy paradigm, have exposed the intellectual sophistry of neo-classical trade economists in trying to explain away the Northeast Asian success in export promotion in conjunction with national market protection.

Second, while the World Bank’s *Miracle* volume and its supporting studies have implied and argued that Southeast Asia began to take off after it embarked on trade liberalization in the mid-eighties, the facts do not support its claims (Jomo, 2001). There certainly was some deregulation during this period, but there also was some new private sector-oriented regulation, more appropriate to the new industrial policy priorities of the governments of Singapore, Malaysia, Thailand and Indonesia.

Third, Southeast Asian trade liberalization may not be what it is made out to be. By pro-actively anticipating the apparently inevitable, some advantage may be regained by deliberate sequencing and timing of trade liberalization. Many trade policy instruments have been excluded by recent trends in international trade governance and are no longer available as options for governments. For example, local content requirements were

phased out with the conclusion of the Uruguay Round of negotiations under the General Agreement on Tariffs and Trade (GATT). However, despite considerable diminution, there still remains some scope for trade policy initiatives in support of industrial policy.

Fourth, there is a big difference between open economic policies and export-led growth strategies in Southeast Asia. While exports may rise with trade liberalization in the short term, imports tend to rise more strongly, especially if the domestic currency appreciates in real terms. Thus, trade liberalization tends to limit or only weakly supplement domestic effective demand. Hence, while increased international trade may enhance growth, the added stimulus tends to be much less than presumed by proponents of trade liberalization. Despite efficiency gains from trade liberalization, increased exports do not necessarily ensure stronger domestic economic growth, i.e. export-led growth.

Finally, there has also been much higher Southeast Asian HPAEs (including Singaporean) reliance upon FDI compared to Japan, South Korea and Taiwan. The much greater Southeast Asian dependence on FDI raises disturbing questions about the actual nature of industrial and technological capacities and capabilities in these countries, especially in their most dynamic and export-oriented sectors. This, in turn, raises concerns about the sustainability of their growth and industrialization processes, especially if they are later deemed less attractive as sites for further FDI, e.g. as more attractive alternative locations become available.

### **Ersatz Industrialization**

Industrialization in Southeast Asia, especially in Malaysia, Thailand and Indonesia has been critically assessed (Jomo [ed.] 2001 and Jomo, 2001, respectively). ‘Good’ industrial policy has been crucial for encouraging technological progress in some resource-based industries as well as for attracting desired (mainly foreign) investments for manufacturing exports. But Southeast Asian – especially Singaporean -- industrialization has been far more dominated by foreign capital, and has, as a consequence, less industrial and technological capabilities that may be considered indigenous or to be under national control. The efficacy of industrial policy has thus emerged as the primary determinant of the ability of different national economies to take advantage of trans-national capital’s relocation of productive capacities in the region. The variety of economies and experiences in Southeast Asia offers valuable insights into various industrial policy instruments, the circumstances in which these may work as well as the importance of relatively un-compromised, competent and effective state capacities in ensuring desirable industrial policy outcomes.

Initial conditions in Southeast Asia were more favourable than in the first-tier East Asian NIEs. Southeast Asia’s economic progress and future are more related to its past, than to its geographic location. Noting the greater commitment and efforts of the first-tier NIEs to education and training, insufficient second-tier Southeast Asian NIE efforts in this regard are likely to limit the potential and pace of technological progress, labour productivity growth and indigenous industrial capability development in the region.

Much heavier reliance on foreign capital to provide industrial and technological capabilities in Southeast Asia has had tremendous implications for sustainable industrial progress in the region. The countries’ potential for sustaining industrial development has been constrained by the interests and strategies of the multinational corporations (MNCs) concerned as the latter respond to a changing world economy offering new opportunities globally (Chandrasekhar and Ghosh, 2001). Southeast Asian industrialization thus provides evidence of the spread and growth of capitalism on the one hand as well as the dominance of foreign capital in the region on the other. Thus, Southeast Asian



industrialization does not contradict, but rather confirms classical theories of international political economy.

The Southeast Asian brand of ersatz capitalism — dominated by *crony rentierism* — has sustained rapid growth and some industrialization in the region for at least three decades despite various weaknesses (Rasiah, 2001). However, Southeast Asian industrial progress may have become less sustainable as export-oriented industrialization in the region has been threatened by economic globalization, particularly financial liberalization. Failure to recognize the true nature of the processes of accumulation and growth in the region — obscured by ideologically tinted perspectives — has prevented the design and implementation of adequate pro-active strategies of well-sequenced liberalization in the face of the apparently inevitable opening of these economies to economic globalization.

Industrial policy interventions of various kinds have been integral to Malaysia and Thailand's embrace of foreign investment-led industrialization. While relaxing restrictions on equity ownership, both countries have used new incentives and infrastructure to influence the content of foreign investment and production activity within their borders. These efforts have intersected with changes in the strategies of Japanese, East Asian, and US MNCs, many of which have developed integrated regional production networks. Yet, diverging policy reforms in Malaysia and Thailand imply contrasting political relations between state and private business elites (Felker, 2001).

Interestingly, Malaysia and Thailand have performed differently in the face of common opportunities for FDI-led industrial change. Malaysia has fostered rapid upgrading in the technological content of foreign manufacturing, but Malaysian-owned industry has remained marginal in most manufacturing industries. Thailand has failed to attract higher technology FDI, but has preserved a modest role for Thai industrial enterprises. These different patterns of industrialization reflect distinct political patterns. Malaysia's 'internationalist' strategy has relied on the capabilities of an autonomous, interventionist state, while stronger business influence in Thailand has bolstered indigenous capability building.

Southeast Asian corporations have financed their investments differently as the role of systems of industrial finance and governments in this process have been quite different. Matthias (2001) suggests that the corporate sectors in industrializing countries finance their investments in ways remarkably similar to those in advanced countries. Although there has been marginally greater use of stock market financing, the patterns that emerge are, in many respects, similar to those of advanced countries. Hence, these industrializing countries can be considered as either 'market-based' or 'bank-based'. In Southeast Asia, Thailand relies predominantly on external financing from bank loans, as is the case in Japan and Korea, whereas Malaysia, like the UK and the US, finances a large proportion of its investments from retained profits (corporate savings), which Akyuz and Gore (1994) have identified as the typical East Asian financing mode.

The Malaysian financial system has experienced tremendous change with rapid economic growth. Since independence in 1957, the role of the financial system has been transformed from primarily financing trade to mobilizing and channelling financial resources more effectively in order to finance new productive activities, particularly the manufacturing sector, which has provided the main impetus for economic growth. Chin (2001) critically reviews the Malaysian experience in industrial financing and identifies several features of banking regulation and priorities that have limited its effectiveness in providing long term resources for manufacturing sector growth.

Export incentives for foreign firms remain very generous, but are generally not effectively tied to specific policy objectives, such as increasing value-added, enhancing

backward and forward linkages or raising export capabilities. Evaluating the role of fiscal incentives as an industrial governance mechanism in Malaysia, Doraisami and Rasiah (2001) argue that generous fiscal incentives since the late 1960s have attracted substantial export-oriented manufacturing investments that have helped generate employment. They argue that the incentives offer too much carrot, and not enough stick, and doubt if the incentives offered actually generate more benefits than the revenue foregone. In fact, many of the incentives seem to be redundant, suggesting that the overall regime has been poorly conceived and not rationalized. Given the high opportunity costs involved and the distortions created, they suggest that some of these incentives should be withdrawn and replaced by others which are more tightly targeted and more strictly performance-based to ensure more value-added manufacturing.

Conventional neo-liberal wisdom attributes Thailand's long-term economic performance since the 1960s to getting the basics right — successive governments have maintained macroeconomic stability, got prices right, provided public goods (infrastructure, education, public health and family planning), and left growth to the private sector. When policy makers deviated from *laissez faire*, as they did with industrial policy, the intervention was limited, incoherent and characterized by rent seeking, according to neo-liberals, who then concluded that it has been ultimately irrelevant to Thai performance. Instead, Thai industrial (micro) policy intervention has been selective, extensive and effective. Rock (2001a) highlights consistent selective interventions in agricultural markets, including markets for agro-industrial exports, successful industry and firm specific interventions besides industrial policy to promote non-traditional manufacturing exports from the 1980s.

The neo-liberal interpretation of the Indonesian state similarly suggests that industrial policy was incoherent, subject to rent-seeking, and irrelevant to Indonesia's post-1966 development success. Rock's (2001b) analysis of state interventions demonstrates that such over-simplification overlooks the elite's success in transforming the colonial economic heritage by using state resources and selective intervention to create a more diversified and industrialized economy. He shows how neo-liberals have overlooked important examples of effective selective intervention. Without these, there is reason to doubt whether Indonesia could have become a second-tier NIE.

Singapore has achieved very rapid industrialization over the last three and a half decades, more than any of its Southeast Asian neighbours. Singapore's strong manufacturing performance has relied heavily on investment by multinational corporations (MNCs), with foreign-owned manufacturing firms accounting for more than 70 per cent of total manufacturing output since the 1970s. Manufacturing in Singapore has also witnessed very rapid technological development, progressing from relatively simple labour-intensive assembly to increasingly capital-intensive and technologically complex industries.

Singapore has also developed indigenous manufacturing capabilities in certain sectors with policies and programs to assist local enterprises while remaining heavily dependent on foreign MNC FDI. Singapore's industrial policy has largely focused on infra-structural support, human resource development and promoting investments in high value-adding manufacturing activities, mainly by foreign firms. Singapore's industrial policy has thus contributed significantly to the development of the country's manufacturing capabilities, offering interesting lessons for other developing countries constrained by few natural resources and a small domestic market.

The island republic's state-led growth strategies as well as the role of SOEs have facilitated various phases of industrial restructuring, including the transition to cluster-based development as well as regionalization (Low, 2001). Singapore's GLCs have displayed a rare success in augmenting rather than draining fiscal resources, and have

actually played a limited, but nonetheless crucial role in transforming the manufacturing sector. The GLCs have primarily been active in areas deemed to be of strategic importance to the country, that neither foreign investors nor local entrepreneurs were willing to enter. Together with MNCs, GLCs have helped Singapore to develop effective industrial policy and to achieve international competitiveness. Singapore's state-led, cluster-based industrial development strategy and market-augmenting industrial policy have been flexibly developed and changed over time.

In summary, Southeast Asian development experiences have been almost as diverse as those of the other four high HPAs identified by the World Bank (1993). Jomo *et al.* (1997) argued that the Southeast Asian high-performing economies have been less successful in developing indigenous industrial and technological capabilities for various reasons, including the greater reliance on FDI and other reasons. Southeast Asia's industrialization is also less impressive in other respects, probably due to its greater natural resource wealth and consequently weaker imperative to industrialize. Industrial policy has been less elaborate, efficient and effective in the second-tier NIE MIT economies as compared to Japan and the first-tier East Asian newly industrializing economies, except for Hong Kong, but including Singapore. This is partly because state intervention in Southeast Asia has been far more abused, and hence, often seriously compromised by politically influential business interests. Yet, it would be a mistake to throw out the baby with the bath water by condemning all industrial policy in the region.

### **Paper Tigers**

Various aspects of the Southeast Asian development story and its suitability as a model for emulation have been critically considered. In the aftermath of the 1997-98 regional financial crises, various lessons have been drawn from the financial crises. The origins and implications of the recent Southeast Asian debacle can be traced to poorly conceived and sequenced financial liberalization that attracted massive, but easily reversible capital inflows into the region (Jomo, 2003). As elsewhere in the region, capital inflows increased substantially with international financial liberalization, especially just before the crisis began in mid-1997. Capital inflows tended to raise foreign reserves, domestic credit availability as well as exchange rates.

Increased capital inflows, credit expansion and exchange rate appreciation have raised aggregate demand more rapidly than GDP, further increasing the current account deficit. While additional credit availability due to capital inflows may well have stimulated total spending due to increased domestic investments, such inflows also supported consumption booms (with high import contents) as well as speculative asset (stock or property) price bubbles. Such temporary increases in demand could not be sustained as the greater external deficit was not sustainable. Worse still, capital flight began as the bubble began to deflate, in a sort of vicious cycle, and was accelerated by panic induced by regional contagion from the collapse of the Thai baht from early July 1997. Weakened prudential regulation encouraged panic, resulting in massive capital flight, facilitated by the preceding financial liberalization.

Greater private sector demand growth due to trade and financial liberalization in the absence of strong contributions from the public sector or from abroad has often contributed to import-led consumption booms, adversely affecting domestic private savings rates. Such increased consumption was encouraged by cheaper imported goods due to import liberalization and real exchange rate appreciation in the region before the 1997-98 crises. It was also enhanced by domestic credit expansion due to increased foreign bank borrowings as well as domestic financial liberalization.

It appears that central banks in the region did not rise to the new challenges posed by financial liberalization and other changes (Hamilton-Hart and Jomo, 2003). National level central banking faced a radically different situation with the new international monetary system that emerged after the US abandonment of the Bretton Woods framework in 1971. Further international financial liberalization from the 1980s added to the new problems to be dealt with by national monetary authorities precisely when the role of government was coming under more pressures for economic liberalization. Regulatory reform simply failed to rise to the new challenges posed by the new international as well as domestic situations.

The role of national authorities in creating the conditions that led to the 1997-98 crises in the region is not to be ignored. As Joseph Lim (2003) argues, it would be erroneous to view countries in the region as innocent bystanders who bore no responsibility whatsoever for what happened. Critically considering various macroeconomic dimensions of the crisis, he rejects not only the International Monetary Fund's (IMF) orthodoxy, but also currently popular views emphasizing liquidity problems or systemic failure. Instead, the region's vulnerability to crisis was due to irresponsible earlier policies with important adverse macroeconomic implications. After rejecting the IMF view, and, by implication, the dominant view in financial markets, he assesses the liquidity crisis view as well as the systemic failure perspective more sympathetically. Finally, he proposes a return to Keynesian analysis, including recognition of the role of investor confidence or 'animal spirits'.

Lim reviews and rejects various myths about the regional crises, e.g. the crises could be overcome simply by reducing aggregate demand, financial markets are always efficient and rational, the crises were mainly due to too much state intervention or lack of transparency, political and social stability are irrelevant to economic crisis, the dichotomy between financial and real sectors of the economy insulates the latter from the former's problems and the East Asian growth model was sustainable indefinitely.

The dangers of ill conceived and poorly sequenced financial liberalization, both at national and international levels leading to the currency crisis, made vulnerable by inappropriate liberalization and precipitated domestic recessions in turn as international conditions became unfavourable on other fronts as well. These sudden downturns were primarily due to systemic liquidity shocks as earlier asset price inflations were suddenly reversed or initially gradual reversals rapidly accelerated. Thus, regional contagion from Thailand's baht devaluation caused regional currency and then financial system crises. Panicky investors and lenders suddenly withdrew capital from a region that had become reliant on net capital inflows. The asset price bubbles had been built on financial houses of cards, that collapsed with devastating effects for the real economy, not only due to liquidity drying up, but also because of reverse wealth effects.

Some policy responses as well as economic recovery records have been critically assessed (Jomo, 2001b) Economic orthodoxy exacerbated the crises by insisting on higher interest rates to defend exchange rates, which worsened contractionary tendencies. Market as well as IMF insistence on balanced budgets also made things worse. Economic recovery in 1999 and 2000 has been strongest in Korea and Malaysia where governments successfully embarked on reflationary policies. The major challenge ahead is for the region's battered economies and authorities to put in place new institutions and mechanisms to embark on a new stage of rapid industrialization and catching-up more generally.

Critical assessment of the real economy must go beyond earlier critiques of the Southeast Asian economic miracle. The economic downturn in Southeast Asia during 2001 underscores the importance of critically considering the pre-crisis miracle and the

problematic prospects for returning to or sustaining the earlier high growth and rapid industrialization trajectory. Critically reviewing the MIT economies' experiences with export-led industrialization before the crisis, Rasiah (2003) extends earlier critiques of Southeast Asian industrialization (e.g. Jomo *et al.*, 1997). The issues raised are not only important for serious consideration of the suitability of the three as models for emulation, but also pose questions which will need to be addressed if the current economic recovery is to be sustained for a new episode of rapid growth and industrialization.

Government efforts to accelerate industrial technological progress in the region have met with mixed, but generally modest success (Felker, 2003). Domestic political priorities have often neglected technology policies, while policy initiatives have also been constrained by the nature of the governments concerned. All too often, technology policies have not been sensitive enough to sector or industry specific conditions. The scope for discretionary policies has also been increasingly limited by economic globalization. Economic globalization is often wrongly equated with trans-border liberalization, but is more accurately understood as involving re-regulation. The new global regulatory frameworks are often far more potent, with enforcement capacities set and effectively coordinated by international organizations, often in response to investor interests and lobbying. Nonetheless, there is still scope for and potential of informed and appropriate technology policies in the region.

With accelerated globalization and regional economic integration in the last decade, the changed international investment environment in the East Asian region has involved fresh constraints due to new international regulations and commitments as well as the more sophisticated industries in some economies (Felker and Jomo, 2003). Investment policy reform was already occurring before the 1997-98 crises. But in the aftermath of the crises, including the conditionalities imposed by the IMF on Thailand and Indonesia for emergency credit facilities, new constraints have been introduced. Attracting new green-field investments to restore and sustain growth as well as structural change is all the more urgent as so much more recent FDI in the region has involved mergers and acquisitions, including 'fire-sale FDI', with little prospect of superior management, but instead, the real possibility of asset-stripping.

The Bank's East Asian miracle story emphasized the key contributions of educational efforts in raising the quality of human resources throughout the region. Southeast Asian educational achievements have generally been greatly inferior to those of the other HPAs (Booth, 2003). There is little evidence that the region's achievements in human resource development have contributed crucially to the rapid growth and industrialization it has undoubtedly experienced. Ironically, the country with the highest share in tertiary education in the region, the Philippines, has not had a particularly impressive economic growth record, admittedly for a complex variety of reasons.

The widespread presumption that Southeast Asia has been together with the rest of the East Asian region in its human resource development achievements requires reconsideration. Uneven educational achievements in the region also challenge the facile policy recommendation that governments should concentrate on enhancing human resources, but only subsidize primary schooling. There is also considerable cause for concern that rapid structural change, industrialization and productivity gains may not be achievable in the future owing to the region's limited and more modest educational efforts.

South Korea and Taiwan have clearly not only achieved far more than the MIT economies in terms of growth, industrialization and structural change, but Northeast Asian inequality has been significantly lower as well. The former two's better economic performances were due to more effective government interventions, especially selective

industrial policy, while the lower inequality was due to significant asset (especially land) redistribution before the high growth period. There is also evidence that economic liberalization in recent years may well have exacerbated inequalities throughout East Asia.

### **From Miracle to Debacle**

Although many were critical of Southeast Asian economic performance before 1998, no one (e.g. Jomo *et al.* 1997) anticipated the Southeast Asian debacle of 1997-98, partly because it was not principally due to a failure of the real economy despite various recognized economic weaknesses. One crucial implication of the greater role of foreign capital in Southeast Asia, especially in light of some globalization trends that became more pronounced in the 1990s, is that dominance by foreign trans-nationals subordinated domestic industrial capital in the region, allowing finance capital, both domestic and foreign, to become more influential and the region to become more economically vulnerable (Jomo 1998).

FDI should be analytically distinguished from other types of capital flows. Chile, which has been very FDI-friendly, has imposed fairly onerous obstacles on easy exit, probably limiting capital inflows, especially of a short-term nature. Capital account liberalization has come under renewed consideration after the East Asian financial crisis since mid-1997, precipitated by an eventually successful currency attack on the over-valued Thai baht and greatly exacerbated by herd-like panicky withdrawals from the entire Southeast Asian region, inducing currency and stock market collapses (Jomo 1998)<sup>1</sup>. Since those who control financial assets usually enjoy disproportionate political influence in most contemporary economies, especially in most developing countries, liberalizing financial markets alone, without offering sufficient inducements for a net inflow of portfolio investments may well cause greater movements out rather than in.

Finance capital in the region developed complex symbiotic relations with politically influential rentiers, now dubbed 'cronies' in the aftermath of 1997-98. Although threatened by the full implications of international financial liberalization, Southeast Asian financial interests were quick to identify and secure new possibilities of capturing rents from arbitrage as well as other opportunities offered by gradual international financial integration. In these and other ways, trans-national dominance of Southeast Asian industrialization facilitated the ascendance and consolidation of financial interests and politically influential rentiers.

Such increasingly powerful alliances were primarily responsible for promoting financial liberalization in the region, both externally and internally. However, in so far as the interests of domestic financial capital did not entirely coincide with international finance capital, the process of international financial liberalization was necessarily partial. The processes were necessarily also uneven, considering the variety of different interests involved and their varying strengths in various parts of the region. History was not unimportant. For example, the banking crisis in Malaysia in the late 1980s served to ensure a prudential regulatory framework which checked the process from becoming more like Thailand's, where caution was thrown to the wind as early external liberalization measures succeeded in securing capital inflows.

Such flows were also desired to finance current account deficits in both countries, principally due to service account deficits (mainly for imported financial services as well

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<sup>1</sup> After the Mexican crisis, with its so-called 'tequila effect', even the IMF seemed to back off temporarily from its previous, almost fundamentalist advocacy of financial market liberalization.

as investment income payments abroad) and growing imports for consumption and output of non-tradeables, mainly in the property (real estate) sector. There is little evidence that such capital inflows contributed significantly to accelerating the pace of economic growth, especially of the tradable sectors of the economy. Instead, it is likely that they contributed greatly to the asset price bubbles, whose inevitable deflation was accelerated by the advent of crisis with such devastating consequences.

There are important lessons to be drawn from East Asia, but clearly, there is no model as such, and most certainly, not one that cannot distinguish the different experiences of Southeast Asia. For a number of other reasons as well, it does not make much sense for anybody or any other country to think in terms of trying to emulate any particular economy in the region or East Asia more generally. There are also reasons why most other developing countries will find it impossible to emulate East Asia even if they want to. Nevertheless, some important lessons can be drawn from the Southeast Asian experiences. Such lessons are best drawn from careful analysis rather than more cavalier broad-brushed generalizations about a rather diverse region.

### **New Challenges for Developmental States**

Economic liberalization, including globalization, since the 1980s has fundamentally changed the environment and conditions for selective industrial policy and, hence, for aspiring developmental states. Most importantly, economic liberalization— at both national and international levels— has seriously constrained the scope for government policy interventions, especially selective industrial promotion efforts. This is especially apparent in international economic relations, but is also true of the domestic policy environment, where IMF policy conditionalities and WTO membership obligations have radically transformed the scope for national economic policy initiatives.

The last two decades have seen widespread, sweeping and rapid opening up of trade, investment, finance and other flows. Very often, such liberalization has been externally imposed by the Bretton Woods institutions as part of conditions imposed to secure access to emergency credit during the debt crises of the 1980s, and more recently, in the wake of the financial crises since the mid-1990s. Various imposed policy packages for (price) stabilization in the short term or for structural adjustment in the medium term have involved such conditionalities. The new intellectual and policy environment which emerged during the 1980s – under Reagan and Thatcher – culminated in the so-called ‘Washington Consensus’, which has promoted such policy reform.

The circumstances of such policy changes as well as the limited government capabilities have meant little preparation in terms of a pro-active strategy or transitional policies to anticipate and cope with the implications of sudden exposure to new international competition. Few tools of the industrial policy instruments of the past are viable or feasible options today, including many that were used successfully in different circumstances in post-war East Asia. Many, if not most of the main industrial policy tools still available are already intensively used by most advanced industrial economies, including those that publicly reject selective industrial promotion. Most advanced economies have a plethora of policies and institutions involved in research and development (R&D), skills training, investment promotion and infrastructure provision, e.g. for the new information and communication technologies (ICT).

These policies are probably necessary, but certainly not sufficient for stimulating and sustaining economic growth and structural change for developing countries to try to ‘catch-up’. Additional policies are urgently needed to prevent such economies – already at a historical disadvantage in various respects – from falling further behind, if not to begin to close the gap with the industrially more developed economies of the North as

well as the newly industrial economies that have emerged in recent decades, i.e. during the last third of the twentieth century.

### *Globalization*

Recent globalization has primarily served the interests of MNCs. MNCs are now believed to account for about two-thirds of international trade. About 40 per cent of such trade takes place within — rather than between — companies. Since the 1980s, internationally integrated production systems (IIPS) — often described by other terms such as ‘manufacturing value chains’ — have grown faster than other contributions to international trade expansion. Thus, new, often changing specialization or divisions of labour have emerged internationally based on differences in wages, skills, technology and logistics. With the growth and spread of TNCs, ‘green-field’ foreign direct investment (FDI) has been rising rapidly, faster than overall production and trade, as well as domestic investment. During the 1990s, mergers and acquisitions (M&As) have come to account for most FDI. While M&As do not add anything to productive capacity in and of themselves, they have contributed to the growing international integration of production.

National economic and technological capabilities have increasingly become important determinants for attracting FDI. Such capabilities may be reflected in the form of internationally competitive industrial firms or clusters. As Lall (2003) has put it, effective globalization relies on efficient localization. In order for investment, growth and structural change to be sustained, it is necessary for the local investment environment to be attractive, requiring significant coordinated pro-active efforts by the local authorities. There is strong evidence of heavy concentration of FDI, particularly in the more sophisticated activities involving greater value addition and worker incomes.

### *Technical Change*

Coordinated pro-active efforts are needed as private agents are unable to respond adequately to the new situations and challenges, and certainly not in the coordinated fashion needed to address the diverse needs of selective promotion efforts in the new circumstances involving pervasive and rapid technical change. Some of the new circumstances to be considered, according to Lall (2003), include the following:

- ‘Compression of space’ with lower and declining communication and transport costs, as well as faster services.
- Greater information availability: more information on a greater range of issues is more easily available and this is likely to grow, rather than recede.
- As markets become much more integrated, new threats posed by greater and sudden competition tend to outweigh the new export opportunities offered by greater access to larger markets, unless the economy has been adequately prepared through appropriate pro-active measures.
- Economic activities have become more technology-intensive, offering potential new benefits (e.g. in terms of technological learning, productivity gains, technology spill-over benefits, management flexibility) for those adequately prepared, but placing others at greater disadvantage. The new technologies require new skills, management, institutions as well as infrastructure. Using the new technologies effectively and efficiently also requires greater domestic technological capabilities as well as new forms of specialization and organization.

East Asia currently leads in terms of economic performance, with fastest growth, greater exports as well as technology intensity. Lall also notes the great divergence between those East Asian countries with and without selective industrial policy, and finds the latter



(mainly in Southeast Asia) far more vulnerable. In contrast, while some more industrialized Latin American countries have developed strong industrial capabilities and skills as well as ICT infrastructure, technology structures as well as R&D remain weak. FDI has been high in Latin America in recent years, but much has been in the form of M&As. Even green-field FDI has not been as dynamic in transforming technological structures and capabilities, as in Singapore or China. In Lall's view, industrial prospects for Latin America are generally quite poor (except perhaps in Mexico) because of inadequate and inappropriate pro-active industrial policies due to the influence of the neo-liberal Washington Consensus.

Industrial development in the new circumstances clearly requires international competitiveness, and such competitiveness is increasingly defined in many regards in manufacturing and related services and institutions, and not simply in terms of wage costs or exchange rate competitiveness, as important as these may be. Inability to compete effectively implies being by-passed, and ultimately, stagnation at the lower end of the technological and income ladder.

Thus, globalization and liberalization have led to growing industrial and technological divergences reflecting differences in industrial competitiveness. Industrial rationalization at the global level — with growing globalization and liberalization — is likely to lead to a concentration of a few major production locations, particularly for successful first movers with strong technological capabilities and industrial agglomerations. Market forces strengthened by economic liberalization cannot be relied upon to check — let alone reverse — such differences in international competitiveness. For the few countries that successfully participate in such globalized production, sustaining growth will increasingly depend on upgrading industrial skills and indigenous technological capabilities, which cannot be assured by previous achievements alone.

#### *New Role For The State*

The major transformations of the recent period have had very significant implications. While economic liberalization at international and national levels undoubtedly constrain and limit industrial policy options, the new circumstances pose new challenges that can only be adequately and successfully met and overcome with appropriate pro-active industrial policy measures. The new circumstances also imply that industrial policy strategies will have to be quite different from previous industrial policy in order to be able to address the new challenges.

New ICT and lower associated costs have reduced and transformed the significance of geographical distances and related time considerations in production and distribution. Meanwhile, rapid technical change and the changing significance of technological advantages – reflected, for example, by strengthened (monopolistic) intellectual property rights – have heightened the significance of technological capabilities, and hence, education, training, research, design and development. Greater international integration of production processes has also dramatically transformed policy options for governments desiring not to be left behind. Pro-active selective industrial promotion measures are therefore especially needed to enhance competitiveness in the face of pervasive market as well as institutional failures, as well as growing recognition that while market mechanisms may be allocatively efficient in static terms, the main challenge for development remains the transformation of country's comparative and competitive advantages in a dynamic sense.

Economic liberalization is often associated with deregulation at the national level. It has involved greater regulation at the international level through a variety of inter-governmental (IMF, WTO, etc.) as well as private organizations (Bank of International

Settlements; standards setting bodies). Meanwhile, market forces have become very real in the sense that seemingly impersonal market mechanisms<sup>2</sup>, often dominated by major market players (powerful MNCs), have been increasingly able to require other market players (including governments) to conform through subtle means such as the implied threat of exclusion or ‘downgrading’.

But economic liberalization, freer markets and more mobile economic resources do not render ‘industrial policy’ obsolete. Instead, new feasible and viable industrial policy options are required in the face of the new challenges and constraints. The development of better as well as more suitable indigenous technological capabilities can only be — irresponsibly — left to markets, which are not capable of being pro-active for development purposes. The main focus of new industrial policy must be on building technological capabilities — in existing activities as well as in more sophisticated new activities characterized by high growth and greater technological and other spill-over benefits.

This does not mean that there is one industrial policy formula or one type of development state for all economies over time. Instead, precisely the contrary is true, i.e. appropriateness to context is very important. For example, the degree of reliance on FDI must necessarily vary with domestic considerations, i.e. existing resources and strengths, as well as perceived inadequacies and the likelihood of such weaknesses being addressed by the presence of FDI. But even the policy outcome of such an assessment must be subject to continuous review, with policy changing with experience as well as changing circumstances.

Strategic pragmatism should prevail, not dogma. In any case, as Lall (2003) reminds us, appropriate industrial policy will require selective interventions as well as effective co-ordination among firms, clusters and factor markets, which should presumably be consistent with a clear and coherent ‘vision’ of the future as well as the ‘road-map’ towards policy goals. For this purpose, there are still many useful lessons to be drawn from the varied experiences of the more successful East Asian NIEs and China, as well as the more modest and flawed achievements of the Southeast Asian NIEs.

### Notes

\* This paper is based on earlier work, some of it published and others awaiting publication. I am grateful to all who have provided me with critical feedback on this work, which has contributed to this version. Needless to say, however, no one else bears responsibility for this version.

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<sup>2</sup> In this sense, the new system of domination and control approximates Gramscian hegemony. Another implication of the distinct historical evolution of such mechanisms of coordination and discipline is its apparent ‘lack of centre’, quite unlike the old empires, though many observers would argue that this has changed radically since the end of the Cold War, and especially after September 11, 2001. While the hand of the market may still be invisible, the rules of the game internationally are increasingly specified and selectively enforced in ways which reflect relative political influence. And while information flows grow in speed and volume, the unequal control of such media tends to reinforce political and market pressures for conformity as well as reform in ways favouring powerful MNCs.

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