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**State and Market in Economic Development: Southeast Asian
industrial policy in comparative East Asian perspective**

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Abstract

This paper offers a nuanced and variegated view of the Southeast Asian economic miracles in comparative East Asian perspective, i.e. by comparing and contrasting the Southeast Asian experiences with those of the other high performing (East) Asian economies, as the World Bank (1993) chose to describe them. It offers a critical look at the received wisdom – via the World Bank – of the region's rapid growth and structural change, before elaborating on the achievements and limitations of the Southeast Asian miracle economies, especially Malaysia, Indonesia and Thailand.

After critically reviewing the World Bank's (1993) influential study of the East Asian economic miracle, the diversity of East Asian experiences is stressed. (Recognizing this diversity enables us to draw appropriate lessons.) The inferiority of the Southeast Asian experiences – compared to their other East Asian counterparts -- is then elaborated, with particular attention given to industrialization as well as other aspects.

These limitations also enable us to understand why the region was more vulnerable to the currency and financial crises that rocked the region in 1997-8 as well as why there are grave doubts about the region's ability to get back on to the high growth path. The 1997-8 Southeast Asian currency and financial crises can therefore be seen as a consequence of socio-economic as well as policy changes, which also seem to raise important doubts about returning to and sustaining the Southeast Asian miracle.

Finally, some reflections are offered regarding the urgent need for a new generation of industrial policy appropriate to current challenges. Economic liberalization - - at both national and international levels -- has seriously constrained the scope for government policy interventions, especially selective industrial promotion efforts. New policies are urgently needed to prevent developing 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. The new circumstances 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. Economic liberalization, freer markets and more mobile economic resources do not render 'industrial policy' obsolete, but rather require new feasible and viable industrial policy options in the face of the new challenges and constraints.

All this is not to suggest that there is one industrial policy formula for all economies over time. Instead, precisely the contrary is true, i.e. context is all important. There is no room for dogma, but strategic pragmatism should prevail instead. 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.

The debate over the East Asian miracle from the late 1980s has tended to focus on the respective roles of the state and the market. Less attention has gone into analyzing the nature of the states and markets in question. In a sense then, like so many other categories in the social sciences, these terms have become reified, acquiring meanings well beyond what their actual significance in history. This, however, is not the place to enter into such a debate.

Instead, the following discussion will focus on industrial policy, i.e. the selective promotion of certain economic activities, usually through state interventions, but often involving increasingly indirect means such as official endorsement or pro-active responsiveness to collective private sector initiatives. Arguably, industrial policy has been an important feature of the emergence and transformation of capitalism in most parts of the world with some possibly notable exceptions (early British and Belgian capitalism).

It is now generally acknowledged that there is no single monolithic and homogenous capitalism. Capitalism has not only changed over time, but has manifested itself differently in various parts of the world owing to various factors. The rapid growth of East Asia in recent decades has led to a great deal of discussion of an ostensibly East Asian capitalism, sometimes described as part of a flock of flying geese following Japan. For different reasons, various observers in the nineties have suggested the distinctiveness of Southeast Asian capitalism in contrast to the rest of East Asia.

From the eighties, and especially in the early and mid-nineties, there has been growing international recognition of the rapid economic growth, structural change and industrialization of the East Asian region, including four economies of Southeast Asia, namely Singapore, Malaysia, Thailand and Indonesia. There has been a tendency to see East Asia as much more of a coherent region than it actually is, and a corresponding tendency to see economic progress in the region as similar in origin and nature. Terms such as the 'Far East', 'Asia-Pacific', 'Pacific Asia', 'East Asia', 'yen bloc', 'flying geese', 'tigers', 'mini-dragons' and so on have tended to encourage this perception of the region as far more economically integrated and similar than it actually is.

Yoshihara Kunio (1988) argued that the fast growing Southeast Asian economies were 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. Ruth McVey (1992) developed a nuanced overview of the nature of Southeast Asian capitalists. 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) criticized the World Bank's claims, suggesting instead various problems associated with the growth experiences of the very economies praised by the Bank.

The East Asian currency and financial crises of 1997-8 radically transformed international opinion about the Southeast Asian capitalist models, with praise quickly transformed into condemnation. Jomo (1998) has characterized the crises as the consequence of international financial liberalization and related increases in easily reversible international capital flows. Yoshihara (1999) has since argued for the necessary conditions for achieving *echt* -- instead of *ersatz* -- capitalism.

This paper focuses on the experiences of Malaysia, Indonesia and Thailand, three economies of Southeast Asia that have been considered high-growth economies, as well as second-tier or second-generation newly industrializing economies (NIEs) or countries (NICs). Sometimes referred to as the MIT economies, they share some common characteristics with Singapore, which is also in the region. However, they are not only far

more advanced in developmental terms, but also quite different as a city-state heavily reliant on trade and financial services besides manufacturing.

Although the MIT economies of Southeast Asia are quite heterogeneous, and at rather different levels of development, the high growth economies in the region have had some similar policies that distinguish them from the other high-growth economies of the East Asian region. Most importantly, the Southeast Asian high growth economies (including Singapore) have relied much more heavily on foreign direct investment 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.

While Singapore, like Hong Kong, has eschewed trade policy instruments, it has used state-owned enterprises (usually referred to as government-linked corporations in the island republic) more than any other East Asian economy. Generally, government interventions in the region have, however, 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 part of this paper critically reviews the World Bank's (1993) influential study of the East Asian economic miracle, before the third section emphasizes the diversity of East Asian experiences and the significance of recognizing this diversity for drawing appropriate lessons. The following part stresses the inferiority of the Southeast Asian experiences – compared to their other East Asian counterparts -- which is elaborated in the following two parts. The fifth section advances the critique of Southeast Asian industrialization, while the sixth part extends the critique of Southeast Asian economic development to other aspects besides industrialization. The seventh section elaborates on the 1997-8 Southeast Asian debacle in the form of currency and financial crises, which seem to have brought an end to talk of the Southeast Asian miracle. The concluding part identifies some new challenges for a contemporary development state, particularly in terms of industrial policy options available.

The World Bank's 'East Asian Miracle'

The most important and influential document recognizing the rapid growth, structural change and industrialization of much of East Asia in the last three decades or more has been the *East Asian Miracle* volume published by the World Bank in 1993. As is now well known (see Wade 1996), the World Bank did not commission the study on its own volition, and with the Japanese slowdown of over a decade and the East Asian financial crisis of 1997-98, there are many in the Bank who would now wish to disown the study.

In fact, it appears that the study was undertaken by the Bank at the behest of Shiratori, the Japanese executive director on the Bank's board. Shiratori had pointed out the region's rapid growth and structural change in sharp contrast to the Bank's poor experience with structural adjustment programs (SAPs) in Latin America, Africa and other parts of the world, and with the transitions it was trying to engineer in Eastern Europe. The SAPs and transitions had generally turned out to be very problematic, even resulting in severe recessions in several of these economies, or rather slow and unimpressive growth rates elsewhere. Shiratori suggested that the Bank should learn and draw lessons from the experiences of East Asia where, by the early 1990s, more than half a dozen countries had grown for at least a quarter of a century at rates exceeding six per

cent per annum. Shiratori offered Japanese government funding for such a study, which the Bank then undertook, apparently rather reluctantly.

In its *East Asian Miracle* (EAM) study, the World Bank identified eight high-performing Asian economies: Japan, the four first-generation newly industrializing economies (NIEs) or countries (NICs), dragons or tigers, namely South Korea, Taiwan, Hong Kong and Singapore and the three second-generation South East Asian NICs, namely Malaysia, Thailand and Indonesia. Interestingly, of course, China was left out, perhaps because the Chinese experience would upset the analysis the Bank offers in that volume in very fundamental ways. The Bank study recognizes that the likelihood of eight relatively contiguous economies growing so rapidly for such a sustained period of time is less than one in 60,000. Yet, it does not acknowledge the significance of geography — unlike the more recent 1997 *Emerging Asia* (EA) study led by the Harvard Institute of International Development (HIID) for the Asian Development Bank (ADB).

With the EAM study, the Bank seemed to have shifted its position from the sort of neo-liberalism, or almost extreme economic liberalism of the eighties, to acknowledging an important developmental role for the state in the 1990s. The Miracle study appears to have had a lot to do with this shift, and this impression has been reinforced by other Bank activities and publications, especially the 1997 *World Development Report* advocating effective — rather than minimalist — states (World Bank 1997).

In the Miracle study, the Bank identifies at least six types of state interventions, which it saw as having been very important in East Asia. It approves of the first four, deemed functional interventions, and is more skeptical of the last two, deemed strategic interventions. Functional interventions are said to compensate for market failures, and hence necessary and less distortive of markets, while the latter two strategic interventions are considered to be more market-distortive. The two types of strategic interventions considered are in the areas of finance, specifically what it calls directed (i.e. subsidized) credit, and international trade, while the four functional interventions the Bank approved of are:

- 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.

It is very important to compare what has actually happened in East Asia with the way the World Bank has presented this.¹ Beginning with the importance of macroeconomic discipline, there is very little dispute that maintaining macroeconomic balances has been important in East Asia. But what the Bank considers to be the acceptable parameters of macroeconomic discipline may be disputed. One finds, for instance, that inflation was generally kept under 20 per cent in the high-performing Asian economies (HPAEs), but it certainly was not always kept below 10 per cent in all the economies. In other words, single digit inflation was neither a policy priority nor always ensured in some East Asian countries during their high growth periods.²

Similarly, when considering other macroeconomic balances such as the fiscal balance and the current account of the balance of payments, one finds that the balances were not always strictly maintained in the way the Bretton Woods institutions now seem to insist on for much of the developing world. Malaysia and Thailand have had relatively high current account deficits throughout the nineties, while other countries with much lower deficits were not spared the recent currency attacks and massive depreciation.

On physical and social infrastructure, until the 1980s, the Bank would probably have gone along with what the East Asians have done. However, since the 1980s, the Bank increasingly seems to be recommending private provision of physical infrastructure. With the exception of Hong Kong, most physical infrastructure in East Asia has been provided by governments until fairly recently, when there have been the beginnings of privatization in the provision of physical infrastructure, which has become the basis for powerful private monopolies associated with ‘crony capitalism’.

The role of government has been extremely important in providing so-called social infrastructure and services in East Asia. In some of its other documents, the Bank seems to acknowledge this, but nonetheless recommends a more modest role for government in the provision of social infrastructure. For instance, the Bank recommends universal and free primary education, but does not recommend the subsidization of education beyond the primary level, when the ‘user/consumer’ (student) should bear the full costs of education as far as the World Bank is concerned. This would have had very serious consequences in terms of human resource development, if one contrasts that recommendation with the actual experience of East Asia. To give some sense of how important government support for education has been beyond the primary level, in Korea today, over 40 per cent of young people of university age attend universities. Thailand has a percentage of close to 20 per cent, Indonesia has 10 per cent, and most of the first-generation East Asian NIEs have well over 25 per cent, generally over 30 per cent.

The notion of good governance is quite ambiguous, and is often used rather tautologically. When things are going well, there must be good governance, otherwise, presumably, things would not be going well. So one does not really have much of an explanation of good economic performance by simply invoking good governance, although it is widely touted these days, sometimes *ad nauseum*. There have been important efforts to try to understand the factors contributing to good governance, and the *1997 World Development Report* has been important and useful in this regard. It seems from the East Asian experience that what was called ‘strong government’, in Gunnar Myrdal’s sense, has been important, though the notion of ‘strong government’ is often misunderstood and wrongly associated with authoritarian government.³

The discussion of ‘embedded autonomy’ (Evans 1995) has become a useful way to try to understand some conditions of good governance. Here, embedded-ness refers to the institutional capacity and capability of the governments concerned to effectively provide the co-ordination necessary for rapid accumulation and economic transformation. Autonomy is primarily understood to be from ‘vested interests’, ‘special interest groups’, ‘distribution coalitions’ and ‘rent seekers’ who, in more favorable or conducive circumstances, would be able to influence public policy to their own advantage. This kind of autonomy is considered to have been very crucial in ensuring that regimes in East Asia could effectively serve as developmental states.

The role of the state in generating savings and encouraging investments is also generally agreed upon. However, much of the high level of East Asian savings actually comprises of corporate or firm savings, rather than just household savings. Household savings in East Asia are not spectacularly higher than in the rest of the world, except in Malaysia and Singapore. The difference in Malaysia and Singapore has been due to the mandatory or forced savings schemes introduced in the late colonial period and the relatively high proportion of the working class or wage-owners as a proportion of the labor force. The latter is particularly true in the case of Singapore, but is also not insignificant in the case of Malaysia. The significance of coerced savings needs mention

because of the popular view that the high savings and investment rates in the region exist because East Asians are culturally if not congenitally thrifty.

The large contribution of high corporate savings implies that firms have often been able to enjoy very high profit rates due to government interventions, subsidies, tax breaks and other incentives for particular types of investments favored by the governments, enabling the firms concerned to enjoy higher 'rents'. But what has been most important is that conditions (e.g. tax incentives and other inducements), largely created by governments, have induced high rates of re-investment of these huge profits by these firms. How have these high rates of re-investment been assured?

In some countries in East Asia, these have been assured by having very strict controls on foreign exchange outflows. Capital flight was made very difficult in some countries in East Asia, especially South Korea and Taiwan, during their high growth periods. Also, by structuring laws so that re-investment of profits has been subject to little or no tax at all, or by offering other incentives to undertake particular types of investments, high levels of re-investment have been successfully induced.

In pursuing these supposedly functional interventions, the East Asian governments were not just market conforming, but instead played important roles which have been more than simply market augmenting, as suggested by the World Bank analysis. On the more controversial, so-called strategic interventions in finance and international trade, the Bank almost grudgingly concedes that financial interventions have been important and successful in East Asia, particularly in Northeast Asia — i.e. in Japan, Korea and Taiwan. However, the Bank implies that nobody else is 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 non-replicable.

Creating the conditions for attracting investment, both domestic private investment as well as foreign investment has had much more to do with reforming incentives and governance more generally to attract particular types of investments to generate specific sources of economic growth rather than liberalizing financial markets as such. Southeast Asian governments, notably Singapore and Malaysia, have especially sought to attract foreign direct investment into areas where indigenous industrial capabilities were not expected to become internationally competitive. Venture capital markets, rather than the usual stock markets, tend to be more supportive of developing new industrial and technological capabilities.

Why did the Bank give a positive evaluation of financial interventions in Northeast Asia despite their clear violation of market norms? A few might suggest that the evidence offers no other possible conclusion, but most observers would dispute this, especially given the ongoing problems of the Japanese financial system. Another explanation is the influence and unorthodox analysis of the last World Bank Chief Economist, Nobel Laureate Joseph Stiglitz, who is credited with being the principal author of this part of the Miracle study⁴.

Since the study had been funded by the Japanese Ministry of Finance (MoF), some cynical commentators have suggested that it was hardly likely that the World Bank would bite the hand that fed it by negatively evaluating the Ministry's record. Given the historic rivalry between the powerful and prestigious Finance Ministry and the bureaucratically weaker Ministry of International Trade and Industry (MITI), recently renamed the Ministry of Economy, Trade and Industry (METI), some Japanese suggest that it is not surprising that the Bank study did not criticize the role of the Ministry of Finance of Japan, but was less sympathetic to MITI and international trade-related industrial policy.

The Miracle volume's evaluation of the record of Japan's 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, with some minor exceptions. However, contrary to the impression given by the study, the Japanese, South Korean and Taiwanese governments did pursue import substituting industrialization policies from the fifties, but soon pursued export-orientation *as well* to ensure that their industries quickly become internationally competitive by requiring a rapid transition from import substitution to export-orientation.

In many cases, infant industries were generally provided with effective protection conditional on export promotion, which 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.

East Asian Diversity

It is instructive to consider some of the important differences among the East Asian economies, particularly to consider whether all of East Asia has been proceeding inexorably in the same basic 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 offering one, or perhaps two variants. However, more generally, as suggested earlier, there has been much talk about East Asia in the singular, as constituting a flock of 'flying geese' or even a 'yen bloc'. Many observers even speak of generic East Asian models, approaches or ways of doing things. In response to the financial crisis since mid-1997, as sentiment on East Asia has turned sour, there have been similar broad-brushed sweeping generalizations about East Asian 'crony capitalism'.

While there certainly are many lessons to be drawn from the East Asian experience, they certainly 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 foreign direct investment (FDI), one finds tremendous contrasts, especially between Southeast Asia and the rest of East Asia. In the case of Singapore, FDI has constituted about a quarter of gross domestic capital formation. In the case of Malaysia, the proportion has been about 15 per cent. 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.

The far greater importance of FDI 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

foreign investment in massive quantities to Singapore, 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.

In the case of Malaysia, the country 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.

Clearly, there is considerable diversity in the role and performance of public investments, including state-owned enterprises (SOEs), in East Asia, including within Southeast Asia. In South Korea, Japan and, of course, Hong Kong, state-owned enterprises 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 state-owned enterprises has also been quite impressive.

In the case of Singapore, for instance, the single largest Singapore foreign investor, in other words, the biggest Singapore firm investing abroad, has been the GIC, the Government Investment Corporation. For quite a number of years in the 1990s, the average rate of return for the GIC's investments was higher than for all major financial investment firms in the City of London as well as on Wall Street, which is no mean feat. Such SOE success poses a challenge for those who insist that state-owned enterprises are bound to fail because of property rights and principal-agent arguments.

There is also tremendous diversity in the role of industrial and technology policies in East Asia. 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.

There have also been different orientations, emphases and instruments in industrial policy in the region. 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 center. There have also been very important differences in the role of technology policy in the region.

As noted earlier, the World Bank recommends that the rest of the developing world emulate Southeast Asia, not Northeast Asia. There are very important differences between Northeast Asia and Southeast Asia underlying the Bank's recommendations. These differences compel us to recognize the achievement of the first-tier East Asia n NIEs (including Singapore) — rather than the transformation of the second-tier Southeast

Asian NICs — as far more impressive and superior in terms of economic performance. The first volume looks at some of the major differences.

Despite the much greater resource wealth of Southeast Asia, one finds that growth performance has been superior in Northeast Asia over the long term. 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 labor force, thus raising the average labor 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 NICs except perhaps for Malaysia, owing to its ethnic ‘social contact’.

Hence, the 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 Southeast Asia. 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.

As noted earlier, 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 primarily driven by foreign direct investment, whereas Northeast Asian industrialization is primarily an indigenous phenomenon.

It is now generally recognized that 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.

These favorable 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.

However, it is important to remember that the supposedly Confucian Kuomintang 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.

There is also the 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 can now be distinguished by higher levels of educational achievement. For example, however, the level of literacy in Korea in 1950 was lower than the literacy rate in contemporary Ethiopia, which has one of the lowest 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 after tremendous resources had been put into education in the preceding two decades.

In discussing initial conditions, 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 (e.g. see Hsiao 1996). 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.

The implications of asset redistribution in Japan were tremendous. 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 (Tsuru 1993). 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.

Thus, the stakeholder economy 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.

Southeast Asian Ugly Ducklings?

Before the currency and financial crises of 1997-98, the Southeast Asian second-tier newly industrializing countries (NICs) were being celebrated by the World Bank (1993) and others as the new models for emulation by other developing countries. In its influential 1993 publication, *The East Asian Miracle*, the Bank argued that eight high performing Asian economies (HPAEs) -- Japan, South Korea, Taiwan, Hongkong,

Singapore, Malaysia, Thailand and Indonesia -- had achieved sustained and equitable export-led high growth and rapid industrialization.

The Bank and others have suggested that owing to various exceptional characteristics of the first five HPAEs, the last three Southeast Asian HPAEs were the most appropriate examples for other developing countries to emulate. Implicit in this recommendation was the claim that the achievements of the Southeast Asian three (MIT) countries of Malaysia, Indonesia and Thailand were similar to and comparable with the other HPAEs in terms of growth, structural change and industrialization. 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.

Closer examination suggests that 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. 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. This strategy of temporary *effective protection conditional upon export promotion* (EPconEP) can hardly be equated with trade liberalization. Recent neo-liberal criticisms (Baer, Miles and Moran 2000) of attempts by an earlier generation (e.g. Ian Little, Jagdish Bhagwati, Anne Krueger) 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.

The 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. Hence, the mid-eighties have been portrayed by the Bank as a period of economic liberalization and deregulation leading to economic recovery and rapid growth and industrialization. Unfortunately for the Bank, 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.

However, given international trends and pressures in recent years, trade liberalization has become increasingly inevitable. But by pro-actively anticipating the apparently inevitable, some advantage may be regained by deliberate sequencing and timing of trade liberalization. Unfortunately, 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.

Thus, the East Asian miracle was characterized as principally due to open economic policies. However, as shown earlier, there is a big difference between open economic policies and export-led growth strategies. And as other studies suggest, while exports tend to rise with trade liberalization in the short term, imports also tend to rise 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.

Besides more modest growth as well as industrialization, there has also been much higher Southeast Asian HPAEs (including Singaporean) reliance upon foreign direct investment (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.

Southeast Asia's Ersatz Industrialization

The conditions contributing to and the nature of industrialization in the four Southeast Asian economies of Malaysia, Thailand and Indonesia have been critically assessed (Jomo [ed.] 2001). The inclusion of these three economies as three of the World Bank's (1993) eight high performing Asian economies (HPAEs) requires closer comparison with the record of Japan and the four first-generation or first-tier East Asian newly industrializing economies (NIEs) of South Korea, Taiwan, Hong Kong and Singapore.

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 uncompromised, competent and effective state capacities in ensuring desirable industrial policy outcomes.

The industrialization experiences of Malaysia, Thailand and Indonesia have seen various weaknesses and abuses of government intervention (Jomo 2001). '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. Southeast Asia's greater reliance on foreign direct investment (FDI) for export-oriented industrialization has also limited indigenous industrial and technological capabilities.

Contrasting initial conditions in Southeast Asia with the first-tier East Asian newly industrializing economies (NIEs) (Booth 2002), one finds that many conditions were more favorable for the latter, though they were not very unfavorable for Southeast Asia. Southeast Asian economies are, in a number of important respects, very different from Japan, South Korea and Taiwan, while Southeast Asia's economic progress and future are more related to its past, than to its geographic location. This challenges the view that the region forms part of a successful 'East Asian model', with common lessons to offer other parts of the developing world. It is especially important to acknowledge the greater commitment and efforts of the first-tier NIEs to education and training. This suggests that insufficient second-tier Southeast Asian NIC efforts in this regard are likely to limit the potential and pace of technological progress, labor productivity growth and indigenous industrial capability development in the region.

Southeast Asian industrialization's much heavier reliance on foreign capital to provide industrial and technological capabilities has 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 transnational corporations 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.

Despite various weaknesses, 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 (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.

State 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 transnational corporations (TNCs), 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).

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.

How have Southeast Asian corporations financed their investments and what has been the role of systems of industrial finance and governments in this process? Rudolph 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.

With rapid economic growth since independence in 1957, the Malaysian financial system has experienced tremendous change. Since independence, the role of the financial system has been transformed from primarily financing trade to mobilizing and channeling 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 Kok Fay (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.

Evaluating the role of fiscal incentives as an industrial governance mechanism in Malaysia, Anita Doraisami and Rajah Rasiah (2001) argue that generous fiscal incentives since the late 1960s have attracted substantial export-oriented manufacturing investments that have helped generate employment. The 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. 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.

Thailand's long-term economic performance has made it one of the development success stories since the 1960s. Conventional neo-liberal wisdom attributes Thailand's success to getting the basics right -- successive governments 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. Michael 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.

Similarly, the neo-liberal interpretation of the Indonesian state 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 newly industrializing country (NIC).

More than any of its Southeast Asian neighbors, Singapore has achieved very rapid industrialization over the last three and a half decades. 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 labor-intensive assembly to increasingly capital-intensive and technologically complex industries.

While still heavily dependent on foreign TNCs, Singapore has also developed indigenous manufacturing capabilities in certain sectors with policies and programs to assist local enterprises. 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.

Singapore's state-led growth strategies as well as the role of state-owned enterprises (SOEs) have facilitated various phases of industrial restructuring, including the transition to cluster-based development as well as regionalization (Low 2001). Singapore's government-linked companies (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 transnational corporations (TNCs), 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.

Southeast Asian development experiences have been almost as diverse as those of the other four high performing Asian economies (HPAEs) 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. This seems to be partly due to the greater reliance on foreign direct investment (FDI) in the region for political as well as 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 three Southeast Asian second-tier newly industrializing countries of Malaysia, Thailand and Indonesia 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. Despite various abuses and other weaknesses in implementation, some industrial policy has been crucial to Southeast Asia's rapid economic growth, structural change and late industrialization (Jomo *et al.* 1997).

Southeast Asian Paper Tigers?

Other 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 2002a). 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.

The combination of increased capital inflows, credit expansion and exchange rate appreciation 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 bath from early July 1997. Weakened prudential regulation encouraged panic, resulting in massive capital flight, facilitated by the preceding financial liberalization.

Increased 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.

Central banks in the region fell short of the new challenges posed (Hamilton-Hart and Jomo 2002). 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.

To emphasize the role of financial liberalization in creating new conditions which led to the 1997-8 crises in the region is not to exempt the national authorities from responsibility altogether. As Joseph Lim (2002) 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 IMF's 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 such as:

- 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
- the East Asian growth model was sustainable indefinitely

Earlier work (Jomo [ed.] 1998) has focused on the dangers of ill conceived and poorly sequenced financial liberalization, both at national and international levels. It is

now well known how the currency crisis -- which began in Bangkok in July 1997-- rapidly spread to the rest of the region, with devastating consequences for financial systems and real economies. These external shocks to financial systems -- made vulnerable by inappropriate liberalization -- precipitated domestic recessions in turn as international conditions became unfavorable 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.

Besides examining the origins of the 1997-98 financial crises, the various policy responses as well as economic recovery records have been critically assessed (Jomo 2002b). 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.

Besides analyzing the regional financial crises and its impact, 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, Rajah Rasiah (2002) 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.

Various official efforts to accelerate industrial technological progress in the region have met with mixed, but generally modest success (Felker 2002). 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 global regulatory frameworks 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.

The changed international investment environment in the East Asian region, with accelerated globalization and economic integration in the last decade, includes fresh constraints imposed by new international regulations and commitments as well as the more sophisticated industries in some of these economies (Felker and Jomo 2002). 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 foreign direct investment (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.

Most accounts of the East Asian miracle have 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 HPAEs (Booth 2002). 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.

These findings and comparisons require a reconsideration of the widespread presumption that Southeast Asia has been together with the rest of the East Asian region in its human resource development achievements. 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.

Clearly, South Korea and Taiwan have 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 Flying Geese to Sitting Ducks

Although critical of the Southeast Asian record and potential, Jomo *et al.* (1997) did not anticipate 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. Although some of the weaknesses identified did make the region economically vulnerable, neither volume addresses 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. As previously noted (Jomo 1998), dominance by foreign trans-nationals subordinated domestic industrial capital in the region, allowing finance capital, both domestic and foreign, to become more influential in the region.

Attracting foreign direct investment (FDI) should be analytically distinguished from capital account liberalization. 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)⁵. 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.

In fact, finance capital developed a complex symbiotic relationship 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 (e.g. see Gomez and Jomo 1999; Khan and Jomo 2000), transnational dominance of Southeast Asian industrialization facilitated the ascendance and consolidation of financial interests and politically influential rentiers.

This increasingly powerful alliance was 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 too 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.

Yet, in both countries, such flows were desired to finance current account deficits, principally due to service account deficits (mainly for imported financial services as well as investment income payments abroad) and growing imports for consumption and output of non-tradables, 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 Industrial Policy

Major developments since the 1980s have fundamentally changed the environment and conditions for selective industrial policy. 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.

There has been a 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.

Invariably, the circumstances of such policy changes as well as the limited policy capabilities of the governments concerned have meant that 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).

Such 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

More than ever before, recent globalization in the last two decades has primarily served the oligopolistic interests of trans-national corporations (TNCs). TNCs 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.

Domestic 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 Sanjaya Lall 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

Given the pervasive and rapid nature of 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. Some of the new circumstances to be considered, according to Lall, 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.

According to Lall’s survey of the developing world for UNIDO, East Asia currently leads in terms of economic performance, with fastest growth, greater exports as well as technology intensity. He 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.

Clearly, industrial development in the new circumstances 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.

For Lall then, 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 implications of the major transformations of the recent period are very significant. 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.

The compression of space and time -- often associated with the contemporary 'post-modern' era -- has profound economic implications that have inadequately influenced economic policy making. New information, communication and transportation technologies 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 allocationally efficient in static terms, the main challenge for development remains the transformation of country's comparative and competitive advantages in a dynamic sense.

While economic liberalization is often associated with deregulation at the national level, it has actually involved greater regulation at the international level through a variety of inter-governmental (IMF, WTO, etc.) as well as private organizations (Bark of International Settlements; standards setting bodies). Meanwhile, market forces have become very real in the sense that seemingly impersonal market mechanisms⁶, often dominated by major market players (powerful TNCs), 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'.

Economic liberalization, freer markets and more mobile economic resources do not render 'industrial policy' obsolete, but rather require new feasible and viable industrial policy options 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.

All this is not to suggest that there is one industrial policy formula for all economies over time. Instead, precisely the contrary is true, i.e. context is all 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.

There is no room for dogma, but strategic pragmatism should prevail instead. In any case, as Lall 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 NICs.

Notes

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1. As Fernando Henrique Cardoso, now President of Brazil, showed in his article on what he called the 'consumption' of Dependency Theory, a very crude and mechanical version became influential in North America, which had very important intellectual and other implications. Similarly, recognizing the institutional differences of East Asia can be obscured by the influence of a particularly dominant or influential perspective, such as the Bank's version of the East Asian difference.
2. For example, in South Korea and Taiwan, inflation rates were often in their teens, and this was conducive to rather than disruptive of investments, particularly in productive assets, and growth.
3. Authoritarian or repressive government may actually be an indication of weak government in the Myrdalian sense. The inability to secure legitimacy from among the population requires authoritarian regimes to resort to repressive measures.
4. The more positive evaluation of the role of the state in the *1997 World Development Report* (WDR), the first since he took over as Chief Economist at the Bank, has strengthened this interpretation. However, some Bank insiders point out that the theme of the 1997 WDR had been decided before Joseph Stiglitz joined the Bank after the untimely death of his predecessor.
5. 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.
6. 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 TNCs.

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