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[Book review] "The East Asian Miracle: Economic Growth and Public Policy by the World Bank"

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performance. We have seen how the achievements made by social reformers in the NIEs have played a leading role in their economic success. The other ASEAN countries, as well, have been implementing their own social reform policies in recent decades; and while the extent of these moves has differed from country to country, we have observed not a few cases of such reform being reflected in economic growth rates. The low growth rates being achieved in South Asia, for example, may be regarded as a reflection of the low levels of social reform realized there. In Sri Lanka and the Philippines, which boast relatively high educational standards, low economic growth rates continue, suggesting the existence of the harsh realities stemming from the direct relationship between reform and the economy at the foundations of these societies. Here and there Oshima does touch on social reforms, like land reform, but this reviewer would have liked him to incorporate into his argument in a little more rigorous fashion the processes by which social reform throughout the monsoon region has not only transformed institutions and the attitudes of the people towards social values, but has also ultimately changed social values themselves.

Despite such questions concerning the factors of ideology and social reform, the reader will find a valuable piece of research here on postwar economic development in Asia, filled with excellent resource materials and plenty of data gathered over a long period of time by a veteran in the field. (Shigetō Kawano)

The East Asian Miracle: Economic Growth and Public Policy by the World Bank, New York, Oxford University Press, 1993, xvii+389 pp.

I

Until the end of the 1980s, the World Bank's approach to development policy followed that of the neoclassical school with its basis in economic liberalization, privatization, and deregulations. In this new book, however, the Bank openly advocates the acceptance of government intervention relative to a country's phase of economic development, a stance which continues the "market-friendly approach" set forth in the Bank's *World Development Report 1991*. This new receptiveness to government involvement in economic development could indicate that a major reversal is taking place in the World Bank's long-standing neoclassical way of thinking.

Behind this change of attitude was the behavior of the United States during the 1980s as it grappled with serious economic stagnation. The new Clinton administraiton, which brought the Democratic Party back to power in 1993, has set its sights on reviving the country's export competitiveness, and favors the adoption of an industrial policy that will coordinate the government and the private sector. Such an approach is tied in with the emergence of what is being called the "new Keynesian" influence within economics, and these new views coming about in the United States have definitely influenced the World Bank's thinking on development policy. These are epoch-making changes which were totally unseen in the 1980s.

It is quite unlikely that a simple perusal of the contents of this book would alert a reader to the changes that are taking place in the World Bank's thinking. A consider-

able amount of the discussion can still be regarded as falling within the framework of neoclassical thinking. Moreover, because this book was put together from numerous background papers written by various authors, one can see from chapter to chapter differing nuances in the debate on government intervention.

What is important when reading this book, however, is not to let one's attention be diverted by the details of the discussion in each chapter; rather one needs to read the contents keeping in mind the historical role which is set forth in this new publication. The World Bank is coming to accept the positive role of government intervention, albeit with conditions attached, and the following review will look in particular at this new stance on intervention.

II

Though entitled the East Asian miracle, the area dealt with in this new book encompasses a rather wider area than that which is generally regarded as East Asia. It takes in not only Japan, the Republic of Korea, and China, but also countries of Southeast Asia and the Pacific area as well. Altogether eight countries are examined which the World Bank labels the "high-performing Asian economies" (HPAEs). These eight are Hong Kong, Korea, Singapore, and Taiwan (the Four Tigers); Indonesia, Malaysia, and Thailand (three of the NIEs); and Japan.

The book is composed of seven chapters. The first, "Growth, Equity, and Economic Changes," deals with the economic performance of the HPAEs since the 1960s, comparing them with other developing countries and extracting traits common to the HPAEs. These traits include: a rapid increase in production and productivity in the agricultural sector, strong growth in the export of manufactures, a rapid decline in birth rate, a high national savings rate with high growth in physical investment, a relative abundance of human capital and its high growth, along with a generally high increasing rate of productivity. Moreover, while they have been achieving high rates of growth, HPAEs have also been carrying out a more equitable distribution of income when compared with other developing countries.

Chapter 2, "Public Policy and Growth," seeks to explain economic growth in the HPAEs from the context of their policies, and this chapter forms the core of the debate in this book. It begins with an examination of the neoclassical and developmentalist (or revisionist) views using this to confirm the appropriateness of the "market-friendly approach" that the Bank advocated in its *World Development Report 1991*. The chapter then sets forth this approach in clearer and more concrete terms calling it "a functional approach to growth." Noteworthy in this section is the notion that competition takes not only the form of "market-based competition" but also "contest-based competition."

Chapter 3, "Macroeconomic Stability and Export Growth," takes up the role of macroeconomic stabilization policies. In the World Bank's view, the HPAEs have held down their fiscal deficits, have kept inflation in check, have maintained their exchange rates at appropriate levels, and have undertaken overseas borrowing only as needed (one reason being that their foreign debt burden has been relatively small), all of which have been orthodox and pragmatic macroeconomic policies and which have been effective in the management of the HPAEs' economic development. The Bank also assesses very highly the ability of the HPAEs to cope agilely with external shocks to their macroeconomies when compared with other developing countries such as Mexico.

Chapter 4, "An Institutional Basis for Shared Growth," deals in particular with the role that institutions have played in the HPAEs' achievement of "shared growth." One point stressed is the factor of bureaucrats being insulated from political pressure. Among the reasons pointed out for this is that the social position of bureaucrats has traditionally been high in the HPAEs; moreover their salaries have matched those in the private sector, and appointments and promotions have been based on ability. Bureaucrats in these countries have made use of "deliberation councils" to play a role in the diffusion of market information, and this has allowed for policy flexibility in coping with changes in the market environment.

Chapter 5, "Strategies for Rapid Accumulation," examines the effects of policies influencing capital accumulation in the HPAEs. It points out that all of these countries have raised the levels of their human capital through public expenditures which have emphasized primary and secondary education as well as science and technology education. Their high savings rate has been made possible through positive real interest rates on deposits and the guaranteed safety of the banks in the HPAEs. Their high investment rates have been due not only to the better prepared infrastructures in the countries but also to tax systems that favor investment and to credit rationing toward economic activities with high profit returns.

Chapter 6, "Using Resources Efficiently: Relying on Markets and Exports," first examines the strategies taken by the HPAEs to achieve an efficient allocation of resources. It then attempts to verify whether or not industrial policies, which are defined as "government-sponsored interventions to alter industrial structure," have produced the desirable economic performances.

In achieving an efficient allocation of resources, the book notes that the HPAEs have flexible labor markets, have carried out sufficient monitoring of policy loans, and have actively introduced foreign technology through various channels. Regarding their industrial policies, however, this book gives a negative evaluation, concluding that the economic successes of Japan, Korea, Taiwan, and the other countries have come about because of a variety of circumstances that happened to work out well. It does not accept that industrial policies have played an important role, and feels that these policies are not helpful or instructive for other developing nations. Chapter 6 evaluates the results of each industrial sector's time series using TFP (total factor productivity) analysis, and comes to conclusions which show, for example, that the improvement in Korea's productivity during the 1970s came about largely in such traditional industrial sectors as textiles, while in the heavy and chemical industries sector where industrial policy was carried out, the increase in productivity was low. From these results, Korea's industrial policy is evaluated as having been ineffective. This negative evaluation of industrial policy based on TFP analysis is reinforced by the defintie failure of the heavy and chemical industries in each of the countries.

Chapter 7, "Policies and Pragmatism in a Changing World," presents the conclusions of this work. Essentially six desirable lessons can be drawn from the example of these HPAEs: (1) the maintenance of macroeconomic stability, (2) a focus on early education, (3) the importance of agriculture, (4) the use of banks to build a sound financial system, (5) openness to foreign investment and technology, and (6) relative prices that reflect economic scarcities. On the undesirable side there are three lessons: (1) promoting specific industries and skipping stages of technological development will generally fail, (2) extremely low real interest rates and large-scale subsidies debilitate a country's financial system, and (3) directing credit to specific industries without selection of borrowers or sufficient monitoring lead to the maldistribution of resources.

One further conclusion is that among the various forms of government intervention, this book sees export promotion as the most suitable policy for a broad-ranging and diversified economic environment.

This highly informative book was released at the end of September 1993, the result of a special one-year World Bank project, and Japan, the Bank's number two contributor, was the major promoter of its release. It must have been Japan's hope of course that from the experiences of the HPAEs, the World Bank would have shown in its analysis that government intervention has worked well. Therefore, the negative stance in Chapter 6 toward policies that foster specific industries can be regarded as a disappointment. On the World Bank's part, it is said that there has been much discussion within the Bank about its having gone as far as it did on the matter of intervention in this book (wherein the Bank expresses its conditional acceptance of government intervention).

Around 1990, some three years before the appearance of this new book, a debate took place within the World Bank over whether or not to publish a report entitled "World Bank Support for Industrialization in Korea, India and Indonesia" in which the Bank undertook a self-evaluation of its activities (only a section of this report carrying the general commentary was published in 1992).[1] This report analyzed the Bank's structural adjustment policies, and along with a positive assessment of government intervention to rectify market failures, it concluded that incentives, government capabilities of implementing policies, and institutions were the three factors that were the key to successful industrialization. The contents of this controversial report which caused so much debate and misgiving have had a definite impact on this new book.

A book of this sort produces many points of discussion, but we would like to turn briefly to a critique of three points that we have questions about. The first concerns the total factor productivity analysis in Chapter 6 for evaluating industrial policy. TFP analysis shows us economic results between one point of time and another, but this does not necessarily mean that the analysis can be stretched to take into account such issues as the linkages between various sectors of industries or the maturing process of an individual industry. And it is precisely on this point that we are not satisfied with the reasoning propounded in the book about the ineffectiveness of industrial policy during the 1970s in Korea, or in any of the other countries in the study. Surely such a grave conclusion cannot be drawn solely from the results of the TFP (as given in Table A6.2 [p. 332]). We expect further explanation will follow in a future report. Furthermore, the ISIC two-digit classification employed to measure TFP seems to be too broad and rough. As industrial policy is the point of focus, it should be at least at the three- to four-digit level to produce results meaningful for the discussion.

The second point is the problem of the definition of industrial policy. This book sees it in a narrow sense and treats it as meaning policy that fosters specific industries. Such industrial policy and government intervention for specific industries is disapproved in this book. On the other hand the book approves of government intervention to promote exports for the benefit of a country's industries as a whole. However, is it possible to separate these two forms of intervention? Japan is a case in point. Here policies to foster targeted industries have been closely tied up with the promotion of exports for whole industries, and there was no clear policy boundary between the two.

The third point is that this book does not analyze government intervention relative to the historical stage of economic development in the developing countries. Compared

[1] The World Bank, Operations Evaluation Department, *World Bank Support for Industrialization in Korea, India and Indonesia* (Washington, D.C., 1992).

to this book, the views expressed in the World Bank's 1992 self-evaluation report cited above are extremely interesting in this regard. As often noted, one reason for a high degree of government intervention during the early stage of economic development following independence is the scarcity of private entrepreneurs who understand the operations of the market. However, because of the high degree of government intervention, many developing countries strapped themselves with an inefficient economy. The 1992 report noted the following: "Any current strategy must also take into account the structure of policies accumulated over the past. In many cases, this structure is highly interventionist, irrational, non-economic, poorly designed and implemented, and riddled with vested interests and rent seeking. To launch a new strategy in such circumstances will first require an extensive dismantling of controls, regulations, protection, and investments. Such liberalization is often a necessary condition for successful industrialization. In addition, there may be a case for effective promotion of industry to remedy market failures and restore efficient market forces."[2]

III

Looking specifically at the World Bank's views on government intervention, this topic can be interpreted in the following way.

The perception of the role of government in development can be divided into three categories: the neoclassical approach, the market-friendly approach, and the developmentalist approach.

Within the neoclassical approach, the book lists four roles for government: (1) maintaining macroeconomic stability, (2) preparing and maintaining a legal system that facilitates domestic and international competitiveness, (3) promoting international trade and eliminating price controls, and (4) facilitating investment in human capital. Meanwhile, the developmentalist approach, particularly that of Japan and Korea which has emphasized policies fostering targeted industries, is rejected by the World Bank. Implementation of such fostering policies requires a first-rate bureaucracy, a condition which the book feels is difficult for most developing countries to meet.

The market-friendly approach requires the government to play a bigger role than that acceptable within the neoclassical view. This approach is mainly based on the principle of competition, and it accepts selective intervention by the government which is directed toward promoting competition. This approach emphasizes three points in particular where government intervention plays a role in correcting market failures. These are: (1) coordination failure, (2) credit rationing, and (3) information-related externalities. In recent years these three have been the topics of much debate within the field of economics, but it should be noted that this approach rejects the developmentalist role of government involvement in fostering industries. Regarding coordination failure and information dissemination, the World Bank has given high marks to the role played by the Japanese deliberation council in coordinating the private and government sectors. Likewise in the area of credit rationing, the Bank has evaluated highly policies that have been carried out through contest-based competition. However the implementation of these also requires a top-notch bureaucracy, and for this reason the Bank takes a negative view about their applicability to other developing countries.

Moreover, this book lays particular stress on export promotion as an area for government intervention. It divides the export promotion policies of the HPAEs into two categories: the developmentalist approach used in Northeast Asia (Japan and

2 The World Bank, Operations Evaluation Department, p. 3.

Korea) and the market-friendly approach of Southeast Asia (Thailand, Malaysia, and Indonesia). The latter relies on foreign investment and market competition through incentives and not on selective intervention. The Bank labels this approach "export-push strategies," and is the one that it recommends for other developing countries.

This Southeast Asian model has the following characteristics: (1) the maintenance of a liberal trade environment for exporters, (2) provision of financial and support services for small and medium-sized exporters, (3) improvement of government services connected with trade, (4) the attraction of export-oriented foreign direct investment, and (5) the development of infrastructure for promoting exports. This model also provides four general rules for government intervention: (1) it is limited only to areas where the market principle is not functioning, (2) targets are selected and policies appropriate for those targets are put into effect, (3) a fair evaluation of the activities of the private sector is made and a mechanism for incentives is provided, and (4) after the targeted objectives have been achieved, intervention is terminated and the market principle is allowed to prevail.

Three questions can be posed about the World Bank's conclusion that government intervention should follow the Southeast Asian market-friendly approach. First, with export-oriented foreign direct investment playing such a big role at least initially, there is certainly a need to examine whether or not other developing countries have the same ability as Southeast Asia to attract foreign investment. The second point is that while this book rejects the applicability of developmentalist policies to all other developing countries, it accepts selective intervention where the government's role is to make up for market failures in areas of coordination failure, credit rationing, and information-related externalities. At the same time it favorably assesses the role of contest-based competition which is part of the developmentalist approach, thus not rejecting all policies for fostering industries. So we think that one should not deny sector-specific industrial policy altogether, but propose industrial policy with conditions that sustain and promote competition. The third point, and one related to the second, is that an effort should be made to bring the market-friendly and the developmentalist approaches together into an optimum mix, and to see whether or not this could be applied to other developing countries. Henceforth these are going to be important issues in the study of the role of government in economic development. More detailed positive analysis of developing countries will be necessary to find the answers.

IV

The rapid changes that have taken place in macroeconomics since the latter half of the 1980s are related to the deteriorating economic conditions that the United States has been experiencing, and which have been the worst since the Great Depression.[3] This deterioration of the American economy turned neoclassical school attention toward economic growth, and people like R. E. Lucas[4] began analyzing East Asian economic growth. Now the neoclassical school also emphasizes the existence of market failure in economic growth and has come to recognize the role of government. Likewise the new Keynesian school, which came to the fore during the 1980s, has made it clear that government has a role to play in dealing with market failure. J. E. Stiglitz and B. C. Greenwald[5] in particular have analyzed from a microeconomic

[3] Joseph E. Stiglitz, *Economics* (New York: W.W. Norton & Company, 1993).

[4] Robert E. Lucas, Jr., "Making a Miracle," *Econometrica,* Vol. 61, No. 2 (March 1993).

[5] Bruce C. Greenwald and Joseph E. Stiglitz, "Financial Market Imperfections and Business Cycles," *Quarterly Journal of Economics,* Vol. 108, No. 1 (February 1993).

basis the effect that credit rationing has on business conditions, and both have advocated the need for government intervention.

As already shown, the production of this book was influenced by these arguments on development theory, and Stiglitz is included among the principal authors of this book. It is indeed interesting that the Clinton administration is taking the same strategy as that presented in this book.

With its release, the World Bank has taken a step forward by openly recognizing the role of government in development, and herein lies the significance of this new work. It points toward a change in World Bank development policy during the 1990s. It is sure to cause a good deal of future debate, and it is definitely required reading for anyone studying developing countries and economic development policy.

(Akifumi Kuchiki and Kazuhisa Matsui)