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Ross Garnaut, Enzo Grilli and James Riedel
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# SUSTAINING EXPORT-ORIENTED DEVELOPMENT

*Ideas from East Asia*

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# SUSTAINING EXPORT-ORIENTED DEVELOPMENT

## *Ideas from East Asia*

ROSS GARNAUT

Division of Economics, Research School of Pacific and Asian Studies
The Australian National University

ENZO GRILLI

World Bank
The Paul H. Nitze School of Advanced International Studies
Johns Hopkins University

JAMES RIEDEL

The Paul H. Nitze School of Advanced International Studies
Johns Hopkins University

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*This book is dedicated to Helen Hughes, Professor of Economics and Executive Director of the National Centre for Development Studies, The Australian National University, 1983–93.*

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# Contents

Cambridge University Press
978-0-521-12136-1 - Sustaining Export-Oriented Development: Ideas from East Asia
Ross Garnaut, Enzo Grilli and James Riedel
Frontmatter
More information

# Figures

Cambridge University Press
978-0-521-12136-1 - Sustaining Export-Oriented Development: Ideas from East Asia
Ross Garnaut, Enzo Grilli and James Riedel
Frontmatter
More information

# Tables

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| | · · | not available. | – | zero. |
| | * | insignificant. | ha | hectare. |
| | n.a. | not applicable. | | |

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More information

# Contributors

HEINZ ARNDT, MA, Oxford University, is Emeritus Professor of Economics, The Australian National University, Editor, *Asian-Pacific Economic Literature.*

KYM ANDERSON, PhD, Stanford University, is Professor of Economics and Director of the Centre for International Economic Studies at the University of Adelaide.

PHILIPPA DEE, PhD, Simon Fraser University, is Assistant Commissioner, Industry Commission, Australia.

PETER DRYSDALE, PhD, The Australian National University, is Professor of Economics and Executive Director of the Australia–Japan Research Centre, The Australian National University.

RON DUNCAN, PhD, The Australian National University, is Professor of Economics and Executive Director of the National Centre for Development Studies at The Australian National University.

CHRISTOPHER FINDLAY, PhD, The Australian National University, is Associate Professor in the Department of Economics at the University of Adelaide and an Associate of the Australia–Japan Research Centre.

ISAIAH FRANK, PhD, Columbia University, is William L. Clayton Professor of International Economics, The Paul H. Nitze School of Advanced International Studies, Johns Hopkins University.

ROSS GARNAUT, PhD, The Australian National University, is Professor of Economics and Head of the Department of Economics and Division Convenor, Research School of Pacific and Asian Studies, The Australian National University.

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More information



ENZO GRILLI, PhD, Johns Hopkins University, is Director of Development Policy and Executive Director for Italy at the World Bank and Professorial Lecturer in International Economics and European Studies at The Paul H. Nitze School of Advanced International Studies, Johns Hopkins University.

ANNE O. KRUEGER, PhD, University of Wisconsin, is Professor of Economics, Stanford University.

E.S. LEUNG, PhD, Johns Hopkins University, is Director, Graduate Studies in Economics of Development, National Centre for Development Studies, The Australian National University.

JAMES RIEDEL, PhD, University of California, is Professor of International Economics, The Paul H. Nitze School of Advanced International Studies, Johns Hopkins University.

DAVID ROBERTSON, PhD, University of Reading, is Senior Research Fellow, National Centre for Development Studies, The Australian National University.

RICHARD H. SNAPE, PhD, London School of Economics, is Professor of Economics and Chairman, Department of Economics, Monash University.

NANCY VIVIANI, PhD, The Australian National University, is Professor of Politics and Dean of Students, Griffith University.

YONGZHENG YANG, PhD, The Australian National University, is a Research Fellow, National Centre for Development Studies, The Australian National University.

CHIA SIOW YUE, PhD, McGill University, is Professor of Economics and Head of the Department of Economics, National University of Singapore.

# *Dedication to Helen Hughes*

Helen Hughes, in a long and distinguished career as an academic and an international public servant, has made important contributions to the subject of this book.

Her list of publications contains 13 books written or edited by her, 38 chapters in books and occasional papers, 26 journal articles and five government reports. From this massive output, there appear to be five significant contributions:

- emphasis on sound infrastructure, rather than financial incentives, to attract foreign direct investment;
- the case for export-oriented, instead of import-substituting, industrialisation;
- the importance of efficient capital utilisation in developing countries;
- the key role, even in export-oriented industrialisation, of sound domestic, especially macroeconomic, policies; and
- demonstration of the fallacy of 'export pessimism'.

**Attracting foreign direct investment**

Helen Hughes came to development economics from economic history, particularly the history of manufacturing. Her first book was a history of the Australian steel industry (Hughes 1964). Her active involvement in economic development came with her appointment to a senior fellowship at The Australian National University to embark on a major study of industrialisation in Southeast Asia. In the next few years, she undertook extensive fieldwork in what are now the ASEAN (Association of Southeast Asian Nations) countries, making contacts at the Asian Development Bank in Manila and ECAFE (Economic Commission for Africa and the Far East) in Bangkok. One offshoot was an annual teaching appointment at the Asian Development Institute. Another was a study of direct foreign investment in Singapore, first surveying Australian investors then, in cooperation with You Poh Seng, organising a collective study of direct foreign investment from all sources.

At that time, there was increasing competition among the governments of Southeast Asia (other than Singapore) and industrialising countries generally, each outbidding the other with tax concessions and other financial incentives. The main conclusion of the Hughes–You study was that this competition, while depriving the competing governments of revenue, had little effect on the overall rate of direct foreign investment or even on each country's share. As Helen put it again recently, 'direct foreign investment flowed into the economy of [Singapore] to take advantage of its low costs, excellent infrastructure and macroeconomic stability. The absence of tax holidays and other incentives was no deterrent' (Hughes 1993). She was not the only one to say this. But her book and contribution to the 1972 PAFTAD (Pacific Trade and Development Conference Series) volume on direct foreign investment helped spread the message and its policy implications.

**Export-oriented industrialisation**

By the time the Hughes–You book appeared, Helen had moved to the World Bank, initially as senior economist in the Industry Division. She began working with Béla Balassa and, after initially feeling compelled to reprimand him for his 'free trade prejudices' (Hughes 1968–71), found collaboration with him fun and soon joined him in the cause of export-oriented industrialisation. Increasing evidence that import-substitution had failed to promote development in Latin America, South Asia and elsewhere had begun to stimulate a shift of opinion towards outward-looking policies. While Little, Scitovsky and Scott were working on their seminal OECD (Organisation for Economic Cooperation and Development) study on *Industry and Trade in Some Developing Countries: a Comparative Study*, she got an opportunity to present the case persuasively as member of a team assembled by the Asian Development Bank to report on Southeast Asia's economy in the 1970s. She observed:

> The further pursuit of import-substituting industrialisation strategies will lead to more high costs and balance of payment difficulties. In the Philippines, industrial growth has already slowed down in the 1960s, and in Malaysia

> and Thailand ... industrial growth is in danger of slowing down in the 1970s, because the relatively easy import-substitution possibilities have been exhausted. An alternative, outward-looking industrialisation strategy, already adopted with remarkable success in Singapore, entails a difficult and painful adjustment of policies (Hughes 1971).

Hla Myint, in his overall report in the same volume, endorsed her recommendation that 'the Asian countries should move away from import-substitution' (Myint 1971:19).

Again, Helen Hughes was not the first to put this view and it would probably have prevailed without her help. But her tireless support for outward-looking policies, inside the World Bank and on many other platforms for a quarter of a century has undoubtedly been influential in Southeast Asia and other parts of the Third World (not least in Australia).

**Efficient capital utilisation**

From 1969 until 1983, as she rose in the World Bank from Chief Economist to Division Chief in the Industry Division, to Deputy Director and then Director of the Economic Analysis Department, collaborating and occasionally sparring with Hollis Chenery, sometimes writing something that caught McNamara's fancy (Hughes 1968–71), she travelled incessantly, on missions to Brazil, Indonesia, Iran, Thailand, Cambodia, the Philippines, and Papua New Guinea, as well as to conferences all over the world. Each mission brought new insights, sparked new ideas. One idea which germinated around 1970, not unrelated to the new emphasis on the export of labour-intensive manufactures, was the widespread waste of capital in developing economies through inefficient utilisation.

Partly because the early postwar literature emphasised capital accumulation as the chief determinant of economic growth, industrial development policies in the 1950s and 1960s had a strong capital-intensive bias. Investment incentives, low interest rates, exemption of capital goods from tariffs, as well as an ideological preference for heavy industry, all contributed to this bias. Underutilisation of capital through single-shift working and other limitations on hours worked not only wasted capital but also restricted employment opportunities for labour. Plant layout and other managerial aspects of 'X-efficiency' further detracted from the intensity of capital utilisation.

In early 1972, Helen Hughes organised a conference on this subject. The report on the resulting research project, which collected data on capital utilisation in manufacturing in four countries in 1972/73, did not finally see the light of day until 1981 (Bautista et al. 1983), but in the meantime the attention that had been drawn to this aspect of industrialisation had made a considerable impact on policy, both in the World Bank and in individual developing countries.

**The key to success in good domestic policies**

During the 1960s the development debate was increasingly dominated by social objectives—employment, basic needs, growth with equity—and in the 1970s by the Non-Aligned Movement's campaign for a New International Economic Order. Helen Hughes, inside and outside the Bank, threw her weight behind the neoclassical view that the key to success was good domestic policies. Certainly, poverty alleviation and greater equality of opportunity are desirable, but both depend on rapid and sustained economic growth. 'Only countries that grow rapidly have the means to redistribute income' (Hughes 1985:5). Since all developing countries face the same international economic order, why were most of the countries of East Asia doing so much better than those of Latin America, Africa and South Asia?

The explanation is obviously not natural resource endowment: some of the most rapidly growing countries were least well endowed with natural resources. 'Cultural characteristics are also poor indicators of growth capacity' (Hughes 1985:14). The Confucian culture, which some were giving the credit for East Asian success, had been blamed for China's stagnation in the nineteenth century. Nor does the political system appear to be decisive. 'Some democratic and some autocratic countries are development-oriented. But many are not … Governments have an essential role to play in establishing social and political cohesiveness and the rule of law' (Hughes 1985). But the key economic policies are monetary, financial and associated exchange rate policies which set the parameters; trade policies which largely determine the efficiency and competitiveness of domestic industries; fiscal policies which determine the resources available for physical and social infrastructure; and manpower policies which determine the real cost of labour.

This summary is taken from Helen Hughes' 1985 paper for the Group of Thirty, but the paper merely restated the sermon she had preached for a decade and more. It inspired much of her academic writing and promotion during the 1980s, about *Achieving Industrialisation in East Asia* (Hughes 1988a), about 'Explaining the differences between the growth of developing countries in Asia and Latin America in the 1980s' (Hughes 1988b) and, more generally, about 'Development policies and development performance' (Hughes 1993b).

**Fighting export pessimism**

In 1983 Helen Hughes returned to Canberra as Director of the ANU Centre which she soon elevated into the National Centre for Development Studies. The highlights of the decade since then have been academic entrepreneurship and influential reports for the Australian government rather than studies in development economics. However, she has continued to expound her views, with one new twist which deserves to be listed as a contribution. This is her denunciation of 'export pessimism'—the notion that export-oriented industrial development is bound to fail sooner or later because markets for labour-intensive manufactures are limited and increasingly constrained by protectionist policies in the industrial countries.

She has argued vigorously that this pessimism flies in the face of the empirical evidence and ignores the dynamics of world trade. The East Asian developing countries have steadily and rapidly increased their exports of manufactures to the United States and Japan and, more particularly, to one another in the form of burgeoning intra-industry trade. In 1989 she organised a conference on the dangers of export pessimism, the proceedings of which she edited (Hughes 1992). She stated the thesis in her introduction:

> Export pessimism—the belief that exports from developing countries cannot successfully penetrate the industrial market economies of the developed nations—has undermined the export performance of many developing countries. It has been proved wrong in practice by rapidly growing developing countries. Yet many developing countries continue to take a pessimistic view of their export potential, only half-heartedly liberalising their trade policies. Export pessimism thus becomes a self-fulfilling prophecy ... Despite the increase in the number of

countries opting for export-orientation and despite the diversification of their export products, the countries of destination have proved flexible enough to adjust their economic structures to growing competitiveness. The export pessimists continue to be, as they always have been, the losers (Hughes 1992:1, 8).

*H.W. Arndt, Canberra*

# *Editorial Preface*

A little over three decades ago the world began to notice that something unusual was happening in Japan. Japan had shared strong economic growth with a number of European countries in the process of reconstruction in the early postwar period. But whereas growth had eased elsewhere, it was continuing unabated in Japan. Observers in the West began to talk about a 'Japanese Miracle'.

Since then, 'economic miracles' have become commonplace in East Asia. Taiwan and Hong Kong began their period of rapid growth at about the same time as Japan—a little awkwardly in Taiwan until it groped its way to the export-oriented strategies that were to sustain strong growth of the 1960s, 1970s and 1980s. Korea joined the process with its adoption of more internationally open policies from the early 1960s. Others were to follow later.

Gradually, it became widely recognised that there was nothing miraculous at all about sustained rapid growth in poor countries such as China, Singapore, Indonesia and Korea. Many countries are capable of it, if they adopt export-oriented policies, supported by sound policies in other areas. However, there may be economic, political and social preconditions that exclude this possibility in some countries through some periods in their histories; that is an important matter for speculation and research.

Heinz Arndt (in the Dedication) has identified Professor Helen Hughes as the first person to recognise the phenomenon of export-oriented growth, and to profess its value as a growth strategy. At the time, Helen was working in the Economics Department of the Research School of Pacific Studies at The Australian National University. Her subsequent career at the World Bank and then as the founding Executive Director of the

National Centre for Development Studies, gave her plenty of scope for encouraging research and proselytising on the character and virtues of export-oriented growth.

These essays, by Helen Hughes' colleagues and friends from various stages of her career, are about the model of export-oriented growth that emerged in East Asia in the third quarter of the twentieth century, and its sustainability in its home region and beyond.

The collection begins with an essay by Anne Krueger, on the way that the experience of export-oriented growth in East Asia and elsewhere has forced modification of our ideas and development. Open trade influenced growth in the directions anticipated by the old theory, but much more powerfully. The reasons include the competitive disciplines that outward-oriented strategies apply to domestic enterprises, institutions and policies.

Enzo Grilli and Jim Riedel ask how widely we can expect the East Asian growth model to apply. What are its preconditions, and where, outside East Asia, can we expect them to be met? With some qualifications, they conclude that there are reasonable contemporary prospects in, at least, South Asia, Latin America, Eastern Europe and parts of North Africa.

Richard Snape in Chapter 3 traces the development of ideas about the role of trade in development, and their absorption (in varying degrees) into the policies and practices of the international agencies with relevant responsibilities. The special role of the World Bank as an agent of communication of policy ideas is identified and discussed.

Chia Siow Yue in Chapter 4 looks across the East Asian experience—including that of the newcomers in Southeast Asia—and seeks to draw some general conclusions about the role of government in the success of export-oriented growth in East Asia. Some aspects of government's role stand out as necessary conditions: macroeconomic policies that deliver stability in reasonable degree; provision of a range of public goods that are essential for development. 'Industry policy' interventions to influence private resource allocation have been extensive—more so in some successful countries than others—but there is no consensus on whether they have helped or hindered development.

Isaiah Frank in Chapter 5 examines the remarkable phenomenon of globalisation of production that has emerged over the recent past, alongside the consolidation and extension of export-oriented growth in East Asia. It has been associated with rapid expansion of direct foreign investment—faster than international trade—and growth in services. The pay-offs to open policies (and the penalties for inward-looking policies) have increased. It has become necessary to extend the rules governing international trade to new areas. The Uruguay Round is a start, but there is an important agenda of outstanding issues. The difficulties of managing negotiations on this agenda on a global basis have contributed to the factors driving recent interest in regional economic groups.

Ross Garnaut and Peter Drysdale (Chapter 6) discuss the ideas about regionalism that have emerged around East Asian trade expansion in the period of rapid growth. There has been a substantial increase in the proportion of East Asian trade that is intra-regional. This reflects the operation of market forces and the expansion of trade opportunities that have accompanied economic growth, rather than any discrimination in official policy. Ideas about regionalism that have emerged in East Asia and the Western Pacific emphasise cooperation to reduce transaction costs of international commerce and reduction in tariff barriers on a non-discriminatory basis, and not regional discrimination along the lines of a free trade area. There is now a challenge to the traditional support for the region's unconditional most-favoured-nation status arising out of the increasing interest in free trade areas in the United States, as reflected in the North America Free Trade Agreement. These ideas are intruding into the discussions of Asia Pacific Economic Cooperation (APEC), through the participation of North America, alongside Western Pacific economies. This is potentially damaging to the sustenance and expansion of East-Asian-style growth.

E.S. Leung (Chapter 7) focuses on the important role of the exchange rate and exchange control regimes in East-Asian-style export-oriented growth. Flexible and open exchange regimes have become more important with increasing international capital markets. Sound exchange rate policies support open trade policies and require disciplined fiscal and monetary policies.

Nancy Viviani (Chapter 8) examines the role of development assistance in development. It is now of great importance only for relatively poor and small economies, such as Australia's neighbours in the Southwest Pacific. In these, donors typically balance development against trade, political and other objectives. The value of the aid for growth and development depends on where the balance is struck.

Philippa Dee and Christopher Findlay (Chapter 9) discuss the relationship between population growth and export-oriented growth. There is no reason to think that rapid population growth will reduce the prospects for export-oriented growth, so long as other preconditions and the appropriate policy settings are in place. Neither are there likely to be limits in the export markets that are available to developing countries embarking on export-oriented growth, especially because rapid growth in other countries expands opportunities for any single country.

Yongzheng Yang (Chapter 10) focuses more narrowly on the sustainability of rapid export growth in the largest of the East Asian developing countries: China. There is no evidence that limits on the size of the external markets will block export-oriented growth in China. Further domestic reform is necessary to sustain rapid growth.

The instability and secular deterioration of export markets has raised questions about the sustainability of export-oriented growth in countries whose comparative advantage lies in primary commodities. Ron Duncan (Chapter 11) shows that the severity of problems of instability depends a great deal on domestic policy responses. The use of modern price risk management mechanisms can reduce further the cost of primary commodity price instability in countries with open foreign exchange regimes.

Kym Anderson (Chapter 12) examines the intriguing question of why countries with comparative advantage in agricultural industries have grown relatively slowly. Part of the problem is that insulation of agriculture from world markets in industrial and developing economies alike has increased the instability and reduced the relative level of agricultural prices. These influences are likely to be less important in the future.

David Robertson (Chapter 13) examines environmental limits to growth. He concludes that whatever the limits imposed by environmental deterioration itself, the means of addressing environmental problems that are favoured by political activists and the international community of developed countries are likely to impose important costs and constraints.

The essays are meant to illuminate and illustrate issues that arise in relation to the sustainability of export-oriented growth. They are not meant to cover the whole field, and room has been left for others to follow. Some of the essays contain strong assertions of views for which Helen Hughes herself was well known. That is what the reader should expect from close associates of Helen, to whom the volume is dedicated.

The editors owe a huge debt to Maree Tait, for organising the Festschrift Conference from which the book emerged, for anchoring communications between authors and editors scattered across the earth, and for much highly professional work on the manuscript. We are also very grateful to Lou Will for finalising this book. Our thanks go also to the Australian International Development Assistance Bureau for its financial and other support of this undertaking.

Finally, our thanks to Helen, for lots of stimulation over many years, and for agreeing that colleagues and friends should know her in this way.

*Ross Garnaut, Canberra*
*Enzo Grilli, Washington, D.C.*
*Jim Riedel, Washington, D.C.*