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LESSONS FROM EAST ASIA AND THE PACIFIC RIM

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There has been so much research on the East Asian miracle during the last decade that it is hard to imagine that anything more remains to be discovered -- except for the ever-elusive elixir of growth. Despite that, we need to keep studying these extraordinary experiences, and the three excellent papers in this session provide much enlightenment and food for thought.

I will start by discussing a few points that come up in the papers, and then turn, first, to other research on East Asia, and second, to related experiences in Asia and the Pacific Rim.

East Asia

There really has been a miracle in East Asia -- and that would be true even if there has been no productivity growth in the region. The miracle is that the living standards of over a billion people are being transformed at a rate that doubles per capita income in a decade. Per capita income levels in formerly very poor economies, Hong Kong, Korea, Singapore, and Taiwan, have reached those of the industrialized countries within a generation. And

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[1] International Monetary Fund. These comments were delivered in the Symposium on the Economies of the Pacific Rim Countries, at the Brookings Panel on Economic Activity meeting, September 6 1996. The views expressed are those of the author and not necessarily of the International Monetary Fund.

even if we leave China out of the calculation, and speak of hundreds of millions rather than billions, we would still be dealing with an unprecedented phenomenon.[2]

A second important point on East Asia, which is emphasized in Takatoshi Ito's paper, is that there is almost no generalization that applies to every fast-growing country in East Asia, not even the fact of very high rates of investment and saving, where Hong Kong is the exception. Although Hong Kong is different because it serves as a gateway to China, we need to be aware of the exceptions listed by Ito to the standard generalizations.

A great deal has been made recently of the generally low productivity growth rates found in East Asian economies. East Asian growth, it is said, is due "merely" to high saving rates. Far from being a caution, that would be an extremely encouraging result, for it means that a country does not need superhuman qualities to grow, but only to save and invest enough.

However, as Barry Bosworth and Susan Collins emphasize, there remains the critical question of how to produce such saving rates. One view is that growth produces saving, via the life cycle hypothesis. As Christine Paxson has recently shown, the evidence is not really consistent with that view.[3] In some countries, such as Singapore, government-mandated saving schemes have been an important element in increasing saving. Postal saving schemes

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[2] It is likely that current statistical methods somewhat exaggerate China's growth, and that the double-digit growth rates of recent years will tend to disappear when the data are rebased. The Chinese miracle will be hardly less impressive for the change.

[3] Christina Paxson, "Saving and Growth: Evidence from Micro Data", European Economic Review, 40, 1996, 255-288.

have also helped. The correlation between saving or investment and growth is extremely impressive, and I am convinced that increasing the share of investment is one of the keys to increasing growth. But we do have to explain the Hong Kong exception.

We must also remind ourselves that it is no mean feat to be able to stay on the production function while investing 40 percent of GDP. Paul Krugman has argued that the East Asians should be wary of the Soviet precedent, but the Soviets did not manage to stay on the production function as they accumulated capital at very high rates: rather, productivity growth was negative. Even though Yung Chul Park warned us that much of the investment in East Asia is wasteful, the aggregate evidence is that investment in East Asia has been about as efficient as in the leading industrial countries, despite extraordinary rates of investment. That is a key part of the miracle.

We also need to remind ourselves that estimates of productivity growth are sensitive to both the assumed parameters of the production function, and its functional form. My IMF colleague, Michael Sarel,[4] shows in a recent paper that by varying capital's share within the range of 0.3 to 0.5, and by making some other reasonable assumptions, he can produce a wide range of productivity growth estimates for individual ASEAN economies, and can even reverse the ranking of productivity growth rates across countries. We do not yet have a firm fix on the behavior of productivity growth in different countries -- and that is hardly surprising when we are working with an

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[4] Michael Sarel, "Growth and Productivity in ASEAN Economies", mimeo, International Monetary Fund, July 1996.

aggregate production function estimated for an economy undergoing extraordinary structural change, involving massive intersectoral shifts of resources.

What else?

In a recent paper, Joseph Stiglitz has tried to summarize the lessons of East Asian success, and asks whether the policy successes of the region can be duplicated in other countries.[5] The lessons he draws are not very different from those we have been hearing today. Stiglitz lays heavy stress on the role of government, a view that is widely shared. Two aspects should be emphasized. First, governments have consistently used markets rather than tried to supplant them: in the non-communist countries, production has generally been a private-sector activity; they have used price signals rather than tried to suppress them; and they have all been heavily export-oriented. This latter aspect is critical. The World Bank' study of the Asian miracle stressed the role of contests among firms as a means of ensuring competition even before market competition dominated. Second, governments have been adaptable: in the lower income countries they have been active in helping direct resource flows, partly through the allocation of credit; and, as incomes have risen and institutions have developed, markets have played an increasing role.

It is also necessary to place heavy emphasis on macroeconomic stability. None of the East Asian countries shows much tolerance for inflation. In working on another paper, I have looked at an international

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[5] Joseph E. Stiglitz, "Some Lessons from the East Asian Miracle", World Bank Research Observer, 11, 2, (August) 1996, 151-178.

poll on attitudes to inflation, and the data for East Asia stand out. The strongest aversion to inflation is found not in Germany, but in Chinese countries and Singapore. And governments have acted accordingly.

Yung Chul Park asked who would help these countries if they got into trouble. Some, including Korea, have been in trouble in the past, and they have been helped by the IMF -- which will help again if needed. That is easy to predict, because East Asian countries have acted very quickly and strongly when macroeconomic instability has threatened. Their economies have reacted rapidly, in part because it is easier to adjust when investment is at 40 percent of GDP, and a major adjustment can be made by cutting investment back to the still-high level of 30 percent of GDP.

<u>MIT</u>

Although the entire East Asian experience gives grounds for optimism over the prospects for development, that is particularly true of Malaysia, Indonesia, and Thailand. In the distant past, China, Japan and Korea have been very advanced countries; they are in some sense returning to an interrupted growth path. That is less true of the MIT countries, which have also grown at remarkable rates -- in Malaysia's case, while implementing policies to ensure that the benefits of growth reach the indigenous population. Indonesia is similarly impressive because only thirty years ago, it did not seem set for sustained growth that would radically reduce the poverty rate.

These three countries suggest that it is possible to transform a poor country, with no previous development record, within a generation. How? All have shown good economic management, and broad-based primary education.

The role of government has differed, being very active in Malaysia and Indonesia, but less so in Thailand. Indonesia has not relied on exports of manufactured goods to the same extent as the others, but has had the benefit of oil. (Of course, making oil into a benefit and not a curse takes good policies.) Each has been reasonably open to imports. All have maintained reasonable macroeconomic stability, though each is currently suffering from a capital inflows problem and running a large current account deficit -- much larger for Malaysia and Thailand than for Indonesia.

Each could be vulnerable to an abrupt reversal of confidence. But the high levels of investment in each give room to adjust without having to cut consumption sharply. A fiscal tightening would be part of the adjustment. It has been argued today that contractionary fiscal policy leads to capital inflows because it increases confidence in the country. While that effect may be there, the predominant effect is likely to arise from the reduced pressure on interest rates that a tightening of fiscal policy would bring, and thus a reduction in the rate of inflow.

Is there a regional growth effect for the countries in this part of the world? Almost surely -- and almost surely the effect comes not only from the growth of regional markets, but also from learning that success is possible, and what policies can help produce it.

Other Asian and Pacific Rim countries

Developments in (broadly construed) neighboring countries are also important. India, with its population approaching one billion, stands at the threshold of East Asian style growth. Indian reforms have been gaining strength in recent years, and while much remains to be done, the new Indian government is continuing down the reform path, and growth in the 5 to 6 percent range seems well established. One day we will see a South Asian miracle, in which the constraints which have kept India growing more slowly than it should -- including the constraint of a too-large government budget deficit, will be overcome, and India will be able to develop its agricultural sector as a basis for and complement to the development of the industrial sector. And then we may see the other countries of South Asia growing more rapidly too.

Finally, let me talk about one other Pacific Rim country, which we have tended to exclude from discussion, Chile. Here is another country with an extraordinary growth record. Not much of what is supposed to be special about the East Asian experience applies in the case of Chile. Its policies have largely followed the Washington consensus, except with respect to financial sector liberalization and openness to external capital where it has used some of the same controls as have been used in Korea.

One of the lessons to be drawn from the Chilean case and from another Pacific case, which is New Zealand, is just how long it takes for the growth process to take hold after stabilization and after the beginning of reform. It took somewhere between five and 13 years for sustained growth to begin in Chile, depending on whether you count the reforms as starting in 1982 or 1974. New Zealand was reforming for seven years before its growth started.

Concluding comments

What are the prospects in this region? First, the growth process is not about to collapse: the notion that because this is largely an extensive growth process, it has to end abruptly, is just wrong. Second, success in this region breeds success: there _is_ a virtuous circle, even if not all its mechanisms are well understood. Countries have to be vigilant to ensure they don't destroy the process by allowing overheating and allowing the macroeconomy to get out of hand. But none of the East Asians has run excessively easy macroeconomic policies, none has tolerated even double digit inflation, and most have small governments and small budget deficits. So the risk of a prolonged slowdown caused by a need for major macroeconomic adjustments is small.

Nonetheless, the view that growth in East Asian countries will eventually slow as they get closer to the frontier is almost certainly right. That is already happening, painfully, in Japan. It will happen to the richer East Asian countries as they approach the income levels of the industrialized countries. But China and the poorer countries have many years of convergence ahead of them.

One final comment. Every student of the East Asian experience makes a long list of the ingredients of success, but every one of them ends up feeling that is not the whole story, that something -- the elixir of growth -- is missing. At that point most say that the whole package is important: it is not just saving, nor just primary education, nor just exports, nor just using markets, nor just macroeconomic stability, nor just an intrusive or non-intrusive role for the state. It is all of them. Yet as Taka Ito has reminded us, not all the conditions are necessary, even though most of them are. The successes of Chile and New Zealand suggest further caution in drawing definitive conclusions. We do not have a set of necessary conditions, nor do we yet have a set of sufficient conditions.

That means we can look forward to continuing this discussion in future years. Ten years from now I hope we will be discussing the lessons of the Indian miracle, and not much later, the lessons of the African miracle.

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