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Economic Development in East and Southeast Asia

Essays in Honor of Professor Shinichi Ichimura

INSTITUTE OF SOUTHEAST ASIAN STUDIES, Singapore

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Seiji Edited by **Akira**
Naya and **Takayama**



Resource Systems Institute
East-West Center
Honolulu



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PREFACE

This volume is compiled as a tribute to Professor Shinichi Ichimura who has contributed so much to creating a better understanding of development issues and problems in Asia. As shown by the biographical information on the pages following the preface, his active involvement in joint projects and various institutions has enhanced our knowledge of development issues; but his accomplishments go beyond this. Through his active participation in academics and the development of institutions that are dedicated to studying development issues of the region, Professor Ichimura has also contributed to the welfare and development of young scholars who are interested in Asian economic development. Professor Ichimura's accomplishments are numerous and impressive. It is only fitting, therefore, to dedicate this volume to a man who has contributed so much and who continues to share his wealth of knowledge and insights.

The articles that are collected in this volume span a wide range of topics.

As is befitting for a book dedicated to Professor Ichimura, all of the articles examine and discuss development issues and problems that have faced or are being faced by the countries of East and Southeast Asia. Both of the editors and all of the authors in this book have had the pleasure and honor of working with Professor Ichimura at one time or another; and each of us has gained from Professor Ichimura's knowledge and experience. Our heartfelt appreciation goes out to Shinichi Ichimura for his dedication to the economics and academic profession, and for his many contributions to creating a better understanding of the development issues faced by the countries of the region.

This volume represents the combined efforts and dedication of many persons. We would like to thank Professor Mitsuo Ezaki of Kyoto University for his generous support throughout this project. Special thanks go to Janis Togashi for her untiring efforts and outstanding support in preparing the volume for publication. We also acknowledge David Puhlick and Audrey Shono for their editorial assistance, and Cynthia Nakachi for the secretarial help in preparing the manuscript. Without the support, dedication and hard work of these people, this project would never have been completed.

SHINICHI ICHIMURA, 1925–

Professor Shinichi Ichimura was born in Kyoto, Japan in 1925. After being graduated from the Department of Indonesian Languages, Osaka College of Foreign Languages in 1941, he entered and was graduated from the Faculty of Economics, Kyoto University in 1949. After graduate work in economics at Columbia University in 1950–51, he moved to the graduate program at the Massachusetts Institute of Technology, where he obtained a Ph.D. in Economics in 1953. In 1963, he was awarded a Doctor of Economics (under the old system) from Osaka University.

His professional life so far may be divided into two parts. In the first period, Professor Ichimura was a member of the faculty of Wakayama University (Faculty of Economics) from 1949–56, and of Osaka University (Institute of Social and Economic Research) from 1956–68. During this period he also taught at Johns Hopkins University (1959–60), the University of California at Berkeley (1965–66), and the University of Pennsylvania (1966–67). His interests

during this time included both the theoretical and empirical aspects of the then current economic issues including studies on related goods, consumer surplus, nonlinear business cycle theories, national income analysis, demand and supply of money, international trade, and input-output analysis, and the Japanese economy. He produced a number of professional articles and books on these subjects both in English and in Japanese. In the course of this first period, his interest shifted from theoretical research to empirical studies and began to focus more on the Japanese economy. Furthermore, in 1963, he was elected Fellow of the Econometric Society, and was coeditor of *Economics Studies Quarterly* from 1960–65.

His move to the Center for Southeast Asian Studies at Kyoto University in 1968 signals the beginning of the second period of his professional life. At this time his interests changed dramatically and shifted to the study of the Southeast Asian economies. His research encompasses such topics as regional economic research on South Sumatra, agricultural development and the green revolution, the effect of climatic factors on the socio-economic structure of Southeast Asian countries, Japanese jointventures in Southeast Asia, cultural conflicts and labor-management relations, cultural and institutional factors and appropriate technology, economic development of Indonesia, the scope of economic development of Asia, political aspects of development policies, and debt accumulation in connection with the North-South problem.

Not only has he generated a great deal of research in the study of East and Southeast Asia, but he has also continuously encouraged and assisted many young scholars in Japan interested in the field. He has organized private study groups on the Southeast Asian economies, and has directly trained young students. In other words, he has been keenly interested in the welfare and development of young scholars who would like to study Southeast Asian countries. He is an educator as well as a scholar.

Professor Ichimura served as the Director of the Center for Southeast Asian Studies at Kyoto University (the “Center”) for ten years from 1969–79. In this period, the Center grew from an infant institution to a highly-respected research institution, and is now well-recognized as a true center for the study of Southeast Asian countries in Japan.

During this second period, Professor Ichimura was also a visiting faculty member at the Universität Bonn (1980), the East-West Center in Honolulu (1985), the National University of Singapore (1985), and Columbia University (1986). At the same time, he has energetically traveled the world at the request of international organizations and governments. Professor Ichimura has served on a number of advisory committees for various Ministers of the Government of Japan. He has also been serving as a member of the advisory committee for Development Planning for the Director General of the United Nations since 1972. Today, he is still seen in action in various corners of the world.

Recently, Professor Ichimura with other prominent Asian economists established the East Asian Economic Association (EAEA). With its academic orientation and its emphasis on the application of economic theory to current

issues and problems in East and Southeast Asia, EAEA is unique and is expected to be in the forefront of development studies of the region. Professor Ichimura has become the editor of EAEA's journal, *Asian Economic Journal*.

In March 1988, Professor Ichimura retired from Kyoto University and then helped to establish Osaka International University. He has become Vice-Chancellor, Director of the Institute of International Relations, and Professor of Economics at the University. He continues, with even more elan, his study of Asian countries after his "retirement". For example two books were published in 1988 under his editorship: (1) *Challenge of Asian Developing Countries* (Tokyo: Asian Productivity Organization), and (2) *Indonesian Economic Development* (Tokyo: Japan International Cooperation Agency — an Indonesian edition is forthcoming from the University of Indonesia).

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INTRODUCTION

SEIJI NAYA
and
AKIRA TAKAYAMA

The dynamic economic performances of the East and Southeast Asian nations have caught the attention of many around the world. During the 1970s and 1980s, these economies as a group grew faster than most other countries in the world. Over the period 1970–79, for example, real GDP grew at an annual average rate of more than 9 percent in the newly industrialized economies (NIEs) — which include Hong Kong, Korea, Singapore, and Taiwan — and more than 7 percent in most of the ASEAN (Association of Southeast Asian Nations) countries. Even in the Philippines, real GDP grew at 6 percent in the 1970s, which was higher than growth in most other developing countries in the world in the same period. In the 1980s, despite the turndown in the global economy, the trend has continued with real GDP in the NIEs and the ASEAN economies (again except for the Philippines) growing at about 7 and 5 percent, respectively.

As a result of their phenomenal performance, these countries have increased

their shares of world output and have also raised their share of world exports. In 1970, the NIEs and ASEAN countries comprised 0.8 percent and 1.0 percent of total world output. By 1987, these shares had increased to 1.8 percent and 1.2 percent, respectively. The growing importance of these economies in terms of world exports is even more dramatic. From 2.2 percent and 1.6 percent in 1970, the share of exports from the NIEs and ASEAN countries to total world exports have grown to 8.3 percent and 2.4 percent, respectively, in 1988.

Indeed, this is the only region where some countries have graduated or are graduating from the ranks of the Third World. The successful development experiences of these Asian economies can serve as a laboratory to enrich economic theory and a large number of projects have been devoted to studying and analyzing their development strategies. In addition, the success of the NIEs and the nations of ASEAN has had a very favorable demonstration effect. As a result, countries such as China, India, and nations in Latin America have shown a great deal of interest in the development experiences of the East and Southeast Asian economies.

This volume represents a comprehensive collection of papers covering a wide range of development issues and problems the East and Southeast Asian economies have encountered, are facing, or will be confronted with in the near future. Because the topics for the papers were left at the discretion of the authors, the subject matter of the papers cover a wide range. At the same time, the papers cover timely issues. Thus, the volume is a good reflection of the many real world problems facing the economies of East and Southeast Asia.

The papers by George Hicks, Malcolm Dowling, and Chong-Yah Lim give an overview of the economic development experiences of the East and Southeast Asian countries and provide a good launching pad for the remainder of the volume. George Hicks' article surveys economic development theory since the 1960s, and contrasts the development strategies that were chosen by the NIEs with other developing economies and looks at the outcomes of the policies that were followed. The article by Malcolm Dowling analyzes economic growth and the changing economic structures of the East and Southeast Asian developing countries, and assesses the prospects for growth in the region in the 1990s. Chong-Yah Lim's paper provides a different perspective on Taiwan's phenomenal economic success and methodically examines the various factors that have been suggested as the sources of Taiwan's growth.

The importance of good macroeconomic policies in achieving rapid economic growth and development, in particular, industrialization and employment policies, is highlighted in the papers by John Wong, Ji-Hong Kim, and Nguyen Xuan Oanh. Because of differences in history, culture, and initial conditions, every country cannot follow the exact path of the NIEs, but many countries in the region (as well as in other parts of the world) have moved toward outward-looking and market-oriented policies. The paper by Nguyen Oanh showcases Vietnam as one example where a shift in industrial strategy has

taken place in Asia. The essay by John Wong focusses on the industrial policies of Singapore in the 1970s and 1980s, and the impact of these policies in fostering employment and output growth. Two lessons are brought out in the analysis: (1) A short-term policy, in Singapore's case the high-wage policy of the early 1980s, is an inappropriate policy tool for economic or industrial restructuring which is essentially long-term in nature; and (2) The optimal level of government involvement in an economy is a complex question and involves choosing an appropriate mix that combines a level of institution support with the working of an effective market system.

The governments of many of the East and Southeast Asian countries have had to face or may soon have to deal with the problem of phasing out declining industries as their economies move up the ladder of comparative advantage into more capital- and technology-intensive industries. The government's response to these problems will be a significant factor and Ji-Hong Kim's analysis of the Korean government's policies toward two declining industries — the shipbuilding industry and the coal mining industry in Korea — indicates that while government intervention may be necessary to ease adjustment in certain declining industries, the government must be wary of contributing to further distortions in the market.

Trade has played an important role in the development of the East and Southeast Asian economies, and will continue to be a significant factor in the future growth of these economies. The papers by Narongchai Akrasanee and Somsak Tambunlertchai, Mari Pangestu, and W.L. Chou and Tzong-Biau Lin examine the different trade issues facing these nations and the response of the governments in addressing the various problems facing them. While adoption of an import-substitution strategy can result in the creation of inefficient industries in a developing country, Narongchai Akrasanee and Somsak Tambunlertchai argue that adoption of this strategy may be appropriate for some economies, such as Thailand, in the initial stages of development. They argue further that import substitution and export expansion are not necessarily mutually exclusive policies. At the same time, the authors note that export expansion and more outward-looking trade policies have been, and will continue to be, important factors contributing to industrial and economic growth in Thailand.

Mari Pangestu looks at another trade-related issue and examines whether Indonesia suffered from the Dutch disease effect. The analysis shows that the booming oil sector in Indonesia did in fact stifle growth in other sectors of the economy, and the government's devaluation of the Indonesian rupiah provided only temporary relief to the nonoil traded goods sector.

The effects of devaluation of a domestic currency are also explored in the paper by W.L. Chou and Tzong-Biau Lin. The impact of a devaluation of the Hong Kong dollar (as well as changes in government expenditure and investment) on macroeconomic aggregates is analyzed using an econometric model.

In an innovative paper by Manuel Montes, a rent-generating model is employed to analyze the effect of rents that are earned from access to government

subsidies or protection on the economy. The theoretical model suggests that increases in rents that are not reinvested in the domestic economy but that are spent on imports or capital flight will lead to slowdowns in domestic demand and rising unemployment. Attempts to maintain full employment in the economy through stimulation of aggregate demand may then bring the economy closer to its foreign financing limit. Although the model was not empirically tested in the paper, the essay presents an original application of economic theory to practical issues facing the developing economies.

In Asia, the share of direct foreign investment (DFI) to total capital formation is generally small, except in certain sectors such as the petroleum industry. In addition, the balance-of-payments effects of DFI are not large either. Nevertheless, as noted in the paper by Eric Ramstetter, the magnitude and effect of DFI is not insignificant in the manufacturing sector of some countries, in particular Taiwan. Using a macroeconometric model that highlights the role of DFI, Ramstetter concludes that differences in the marginal product of capital between domestic and foreign firms can result in significant differences in production and that multinational corporations play an important role in the trade of developing economies.

The paper by Chung Lee examines the pattern and trends of DFI in Korea and evaluates the impact of the country's DFI policies. The paper's conclusion that Korea's restrictive policy on DFI until the mid-1980s may or may not have been the optimal policy reflects the complexity and difficulty of analyzing effects of DFI. Lee concludes that the question cannot be fully answered without a careful analysis of the effectiveness of Korea's industrial policy.

An important point about the extent of technology transfer arising from DFI is made in the paper by Mingsarn Santikarn Kaosa-ard. Many of the benefits of DFI come from the transfer of knowledge and technology; but technology cannot be simply bought or imported. A country must build its capacity to absorb the technology. Technology transfer is therefore not a static concept, but is a process that depends upon capacity-building by the recipient country through investments in human resource development and science and technology.

Consistent with the movement toward a more market-oriented and outward-looking development strategy, the East and Southeast Asian economies have undertaken a number of reforms in their financial markets and exchange rate systems. The paper by Christina Liu and Shirley Kuo examines the interest rate and foreign exchange liberalization that took place in Taiwan since 1980. Their analysis of the Taiwanese experience supports the widely-accepted order of liberalization — that the domestic financial markets and the trade account should be liberalized prior to liberalization of the capital account in order to prevent speculative capital flows that may lead to other financial problems.

In the essay by Yen Kyun Wang and Wan-Soon Kim, liberalization of the forward foreign exchange market is viewed as an important element of foreign exchange liberalization. A sound and active forward foreign exchange

market would improve the country's export competitiveness by providing a means by which trade contracts can be protected from foreign exchange rate changes.

Debt has not been a major problem in East and Southeast Asia primarily because these countries have relied more heavily on good domestic policies to make necessary adjustments to external shocks and less on foreign debt. The Philippines is the exception, but indications are that the country is regaining strength though a large amount of foreign assistance will continue to be needed. Nevertheless, the straightforward presentation of the many options facing developing countries in terms of debt management by Virabongsa Ramangkura and Pakorn Vichyanond is instructive.

As the East and Southeast Asian countries have developed, the size of the agriculture sector has declined. However, the agricultural sector remains an important one, and increases in agricultural productivity have been and will continue to be an important element in the region's growth. Agricultural growth and the transition toward industrialization are the topics of the papers by Romeo Bautista and William James. Increases in agricultural productivity that occurred in the region and the impacts these increases will have on food imports in the future are discussed in the paper by Bautista. James evaluates the agricultural transition that has taken place in the region and notes that industrialization should not take place at the expense of the agricultural sector, but should be accompanied by a raising of productivity in both the industrial and agriculture sectors.

There has been much discussion recently in academic and political circles about economic integration among the countries of the Asia-Pacific region. While developing countries' attempts at integration have generally not been very successful, the Southeast Asian countries have been able to maintain their unity in the Association of Southeast Asian Nations (ASEAN) and in 1988 ASEAN was as strong as ever. Although ASEAN cooperation has not achieved the kind of success that was initially envisioned, the organization has contributed to political stability and harmony in the region which is now providing the foundation for economic cooperation. The paper by Florian Albuero looks at the prospects for strengthening ASEAN cooperation beyond political unity in the Indochina conflict by examining the results of the third ASEAN Summit Meeting that was held in late 1988. The commitment to expand economic cooperation with the firm goal toward a more market-oriented approach at the summit indicates that ASEAN is likely to move forward toward its goal of regional economic cooperation.

Despite the discussions surrounding economic cooperation in the region, the NIEs and ASEAN countries recognize their interdependence with the rest of the region and the world, and they have maintained their outward-looking approach. As noted in Mohammad Sadli's paper, the Asian developing countries have been taking a more active role in seeking multilateral trade liberalization through the Uruguay Round, the outcome of which is of vital importance to the region. However at this juncture, a successful round is

very uncertain; and for a number of reasons, the GATT may not succeed in effectively liberalizing world trade.

The paper by Pang Eng Fong and Augustine H.H. Tan examines some of the global economic problems from the perspective of the Asian NIEs. The trend toward greater protectionism and managed trade is viewed as a threat to the world economy in the 1990s, and the shift in global economic power implies a need for the United States, the European Community, and Japan to better coordinate their policies and reduce the divergence in their national macroeconomic policies.

As the editors of the volume, we take great pleasure in presenting these papers which are not only informative, but also yield significant insights into the issues confronted by the developing economies of East and Southeast Asia. It is especially pleasing to find that economic theory remains a fundamental component of research being conducted in the field and continues to be applied to practical problems.

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