NEW DEVELOPMENTS IN THE WORLD ECONOMY: A TOUGH AGENDA FOR MICS?

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Ajit Singh

Emeritus Professor of Economics, University of Cambridge
Life Fellow Queens' College Cambridge
Tun Ismail Ali Chair, University of Malaya, Kuala Lumpur (2010-11)
Dr. Manmohan Singh Chair, Punjab University, Chandigarh, India

as14@cam.ac.uk

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Abstract

We are living through extraordinary times. During the first twelve years of the new millennium, unusually, developing countries (DCs) expanded faster than advanced countries (ACs). IMF suggests that the improvement in DCs during this crisis is due to their ability to absorb shocks. In the most recent period, there has been a reduction in growth rates in most middle-income countries (MICs) as well as in advanced countries. The paper's second part examines the epic story of South Korean industrialisation. A fundamental argument here is that developing countries have much to learn from each other. This brief presentation ends on an important point that the South-South cooperation is not intended to replace North-South cooperation but rather to supplement it.

Keywords: new millennium, IMF, South-Korean industrialisation

JEL Codes: J2, O1, O3

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1. Introduction

This paper comments on the following issues. First it outlines the present extraordinary state of the world economy which departs much from previous historical experience. This refers specifically to the factual observation that developing countries have grown at a much faster rate than the developed countries since, at least, the beginning of the new millennium. Secondly, the paper will comment on the lessons to be drawn from the experience of Korea, the most successful industrialisation story in the history of mankind. Thirdly, the role of the government and of privately-owned large firms in the Korean economy will be scrutinised. Fourthly, the mechanics of knowledge-sharing between developing countries will be analysed. Fifthly, the role of trade unions, labour and the struggle for democracy in the evolution of South Korea's economy and polity will be examined. Sixthly, the role of competition and competition policy in Korea will be discussed together with their implications for policy for other countries. Finally, a brief conclusion will be offered. To avoid misunderstanding, it may be noted that the above points do not necessarily convey an order of priorities or of economic significance.

2. Growth rate of DCs and ACs in the new millennium

We are living through extraordinary times. During the first twelve years of the new millennium an unusual event has taken place – developing countries have expanded at a much faster rate than developed countries. Five developed countries (US, UK, France, Germany and Japan) achieved an average growth rate of only 1.50 per cent between 2000 and 2012. This compares with the corresponding growth rate of five emerging countries (India, China, Brazil, South Africa and Russia) of nearly 6 per cent. India and China, the two most populous countries have done particularly well. India achieved average annual growth rates of over 7 per cent in the first twelve years of the new millennium while the corresponding growth rate of the United States was a third of that number. China similarly had a stellar growth performance.

Other non-BRICs countries such as Colombia, Thailand, Indonesia, Malaysia, Mexico have also performed much better than the rich countries. Indeed, on the basis of this data, one might argue that the so-called global crisis has affected only the advanced economies while the leading developing economy countries have enjoyed a great leap forward rather than crisis during the first decade of the new millennium (Fennel, Kaur and Singh, 2013)

Excellent performance of the developing countries is one of the most encouraging features of the current crisis. It is not only desirable in itself, but their faster growth rate also helps the world economy. The superior performance of developing countries, as in the current crisis, is a new departure. Not too long ago, it used to be an article of faith among scholars that in a global economic and financial crisis, it is the periphery countries which suffer a prolonged slow-down or worse while the centre takes care of itself. The story in the present crisis seems to be quite the opposite. Why should this be so? An important related issue is whether the good performance of the periphery can be sustained. Here there are conflicting voices from unexpected quarters. The IMF suggests that the improvement in the position of the periphery during this crisis is their growing ability over the past two decades to absorb shocks. The organisation went on to observe, 'Developing countries' improved performance is explained by both good policies and lower incidence of external and domestic shocks' (IMF, 2012). On the other hand, Yilmaz Akyuz, chief economist of the South Centre in Geneva, a developing country think tank, argues that the good performance of the southern countries during the crisis has been largely due to favourable external factors e.g. commodity price rises, increases in capital flows (including remittances), (Akyuz, 2013). However, it can also be argued that developing countries learned and internalised the lessons from their previous experiences with the global crises. They improved their macroeconomic management of the economy markedly, paid close attention to the current account balance, and accumulated reserves to be in a position to run counter-cyclical monetary and fiscal policies during the times of the crisis.

In the most recent period, there has been a reduction in growth rates in most MICs as well as in advanced countries. China's growth rate has fallen from 12.7 per cent in the year 2006 to 7.9 per cent in 2012. Brazil's rate has fallen from 4 per cent in 2006 to 2 per cent in 2012. The fall in Indian growth rate, which has been much criticised at both home and abroad, has nevertheless not been any greater than in other BRICs.

However, the changes in growth rates in rich countries because of their economic downturn, has been even more negative. The average growth rates recorded for the period 2006 - 2012 range from 0.47 per cent per annum in Japan, 1.06 per cent in the US, 0.40 per cent in the UK and 1.51 per cent in Germany. The much decried Indian growth rate of 5.9 per cent for the same period of 2006-2012, looks quite healthy in comparison. However, this necessary correction to the public perception of Indian economic decline is not to encourage complacency. Rather, it is to agree with much recent research that neither India nor China, nor India-China together, can be the locomotives to pull the world economy out of its post-2007 economic decline. This task can only be done by the US and Eurozone economies when they manage to lift themselves out of their current malaise.

3. South Korean industrialisation drive

We take up now the epic story of South Korean industrialisation. In 1960 South Korea was one of the poorest countries in the world, with a per capita income of about one-hundred US dollars. Its economic prospects were regarded as being so unpromising that the US congress recommended the country should be given humanitarian aid rather than the normal foreign aid for economic development. However, in a mere 30 years the country catapulted into the ranks of OECD countries and within the space of 50 years it has achieved a per capita income of twenty thousand US dollars.

Unfortunately, until 1990, the economic history scholarship for East Asian countries was dominated by neo-classical ideas and interpretations which were endorsed by the Bretton Woods institutions. The conventional wisdom was that the South Korean government did not intervene much in the economy. Professor Béla Balaasa (1988) best summed up the analysis of the neo-classical school as well as that of the Bretton Woods institutions[1] in the following terms, 'The above remarks are not meant to deny the role of government in the economic life of East Asia. But, apart from the promotion of shipbuilding and steel in Korea and a few strategic industries in Taiwan, the principal contribution of government in the Far Eastern NICs has been to create a modern infrastructure, to provide a stable incentive system, and to ensure that government bureaucracy will help rather than hinder exports.'

Similarly, the World Development Report (1991) argued that experience shows that the government works best when it follows a market friendly approach to development. This report is a seminal document as it represents what the World Bank economists had learnt up to that time from forty years of development experience. To save 'market friendly' from being a mere tautology, to their credit, the World Bank economists defined it in fairly precise terms as follows:

'*Intervene reluctantly*: Let markets work, unless it is demonstrably better to step in …[It] is usually a mistake for the State to carry out physical production, or to protect the domestic production of a good that can be imported more cheaply and whose local production offers few spillover benefits.

Apply checks and balances: Put interventions continually to the discipline of international and domestic markets.

Intervene openly: Make interventions simple, transparent and subject to rules rather than to official discretion.'

In a seminal and widely acknowledged contribution, Alice Amsden (1989) pointed out that this was a fundamentally incorrect reading of the South Korean economy and economic history. Her book went on to illustrate with chapter and verse the deep involvement of the South Korean government in all aspects of the country's economy.

4. Government and the economy in South Korea

How did it happen? Amsden's explanation is by now common knowledge. The state took a leading role in economic development as befitted a developmental state. The government presided over a regime of subsidies, taxation and industrial policy to increase the rate of investment, to boost exports and to achieve planned industrialisation. One of the notable characteristics of the South Korean narrative is that subsidies or special concessions were given to entrepreneurs and firms only in response to meeting strictly the performance targets set by the government. Often these were export targets, involving new products which were subject to huge uncertainty whether or not they would succeed. However, the firms produced them because they knew that if they followed the governmental edicts, they would be rescued by the government. Thus, the entrepreneurial risk was socialised. After denying for many years that there had been deep government involvement in many areas of economic activity, the World Bank's 1993 Development Report explicitly acknowledged that there had been government controls in all directions. The Report stated:
'Policy interventions took many forms – targeted and subsidised credit to selected industries, low deposit rates and ceilings on borrowing rates to increase profits and retained earnings, protection of domestic import industries, the establishment and financial support of government banks, public investment in applied research, firm – and industry-specific export targets, development of export marketing institutions, and wide sharing of information between public and private sectors. Some industries were promoted while others were not.'
However, the report goes on to suggest that such interventions, particularly in the sphere of industrial policy, had in general a limited effect. Some of these worked for some time in a few countries, but overall they were neither necessary nor sufficient for the extraordinary success of East Asian countries. Thus, according to the World Development Report 1993:

> 'What are the main factors that contributed to the High Performing Asian Economies' (HPAE's) superior allocation of physical and human capital to high yielding investments and their ability to catch up technologically? Mainly, the answer lies in fundamentally sound, market-oriented policies. Labour markets were allowed to work. Financial markets …. generally had low distortions and limited subsidies compared with other developing economies. Import substitution was…. quickly accompanied by the

> promotion of exports….the result was limited differences between international relative prices and domestic relative prices in the HPAE's. Market forces and competitive pressures guided resources into activities that were consistent with comparative advantage…'

In other words, the final policy conclusion was still essentially that of the market-friendly approach to development, albeit in a new packaging. Developing countries were recommended to seek their comparative advantage, to get the prices right, to have free-markets as far as possible.

5. Labour rights and the South Korean labour force

One of Amsden's important contributions was to provide building blocks to construct a new theory of the third world firm in late industrialisation, (Amsden, 2001/2007). She noted an empirical regularity about the operation of firms in countries with diverse cultures and governance systems. This regularity derives from the ubiquitous existence of large privately-owned conglomerate firms in developing countries all over the world. This is true of India, South Korea, Malaysia, Thailand, Jordan, Turkey, Pakistan, Brazil, Mexico and many other countries. These nationally owned and controlled, conglomerate firms had been the spearheads for competing in the international markets and have played a central role in the industrialisation of many countries.

The issue of corporate governance for the large third world conglomerates is important and is rather different from that of advanced country firms. The third world conglomerate firm makes perfect economic sense in a world where there are many missing markets. The result is that third world firms have to produce internally many of the goods which are not available in the market. This is one reason why the third world conglomerates are much more successful than has been the case with UK and US conglomerates which were favoured by the stock market at one time, but later fell into disfavour because of their poor performance.

Students of Korean economic history have had great difficulties in dealing with the questions of labour rights, labour movement and labour markets during the South Korean industrialisation. It is widely alleged that in the Korean industrialisation drive, human rights were ignored and labour was prevented from organising collective action and the weaknesses of the trade unions hindered the progress of democracy in the country. It led to political repression which was at times violent. Scholars of the South Korean economy such as Alice Amsden were criticised for supporting the regime through their writings which painted a very favourable picture of South Korean industrialisation. Amsden's response was that she strongly supported the struggle for democratisation in Korea and specifically she supported students who took a highly active part in the fight for a democratic political order. The transition to democracy has continued to evolve and today one can agree with Professor Amsden that South Korean people can not only take pride in their huge technological and economic advances but also in their democratic regime. It is arguable that without this fast industrialisation and the creation of a working class, democracy may have taken much longer to evolve in Korea.[2]

6. MICs – a tough new agenda

It was argued earlier in this paper that the MICs are faced with a tough agenda if they are to be successful in continuing with their fast industrialisation. The collapse of Eurozone and slow growth in the US makes it much more difficult for developing countries to maintain their growth rates. Dani Rodrik (2011), however, reaches the same negative conclusion but through a different route. He argues that it is the supply side which poses essentially insurmountable problems for poor countries. Fast growth, he suggests, depends on speedy growth of manufacturing-production and to a very limited extent on modern services. Only fast growth of manufacturing-production creates the dynamic economies of scale which lead to steady progress.

Ten years ago, Larry Summers presented a different paradigm based on the standard narrative pertaining to growth:

> ‘I would suggest that the rate at which countries grow is substantially determined by three things: their ability to integrate with the global economy through trade and investment; their capacity to maintain sustainable government finances and sound money; and their ability to put in place an institutional environment in which contracts can be enforced and property rights can be established. I would challenge anyone to identify a country that has done all three of these things and has not grown at a substantial rate (Summers, 2003).’

Rodrik’s response to this argument is stated in the following terms:

> ‘…One of the paradoxes of the last two decades of globalisation is that its biggest beneficiaries have been those countries that have flouted its rules – countries like China and India that have effectively played the game by Bretton Woods rather than post-1990 rules (controlled finance, controlled currencies, industrial policies, significant domestic manoeuvring room). But as such countries become large players and turn into targets for emulation, the tensions become too serious to ignore. How we handle those

> tensions will determine not only the future of convergence, but the future of the world economy as well.' (Rodrik, 2011).

7. The role of *chaebols*

The Republic of Korea did not follow a policy of maximum domestic competition or unfettered market-determined entry or exit of firms. The government in that country, if anything, went one step further than the Japanese in actively helping to create large conglomerates, promoting mergers and directing entry and exit of firms, according to the requirements of technological-scale economies and world-demand conditions.[3] The result is that the manufacturing industry of the Republic of Korea displays one of the highest levels of market concentration anywhere – whether among the developing or developed countries. The top 50 *chaebols* accounted for 15 per cent of the country's GDP in 1990. Among the largest 500 industrial companies in the world in that year, there were 11 Korean firms – a number as high as that of Switzerland.

The UN (1993, p. 43) observed in relation to the Korean industrial structure:

> 'Such a structure is the deliberate creation of the Government, which utilized a highly interventionist strategy to push industry into large-scale, complex, technologically demanding activities while simultaneously restricting FDI inflows tightly to promote national ownership. It was deemed necessary to create enterprises of large size and diversity, and to undertake the risk inherent in launching investments in high-technology, high-skill activities that would remain competitive in world markets. The *chaebols* acted as the representatives and spearheads of the Government's strategy: they were supported by protection against imports and TNC entry, subsidized credit, procurement preference and massive investments in education, infrastructure and a science-and-technology network.'

Nevertheless, there is ample evidence that the big business groups still exhibited highly rivalrous behaviour (Kim, 1992). This was because under rapid growth conditions, as well as under the rules of the game which the State had established, there was neither the incentive nor the ability for big business to collude. The Korean government went out of its way to ensure that big business did not collude by allocating subsidies only in exchange for strict performance standards (Amsden, 1989). After 1975, inter-group competition in Korea became even fiercer as each *chaebol*, or diversified business group, tried to qualify for generous subsidies to establish a general trading company by meeting government performance standards regarding minimum export volume and number of export products (Amsden and Singh, 1994).

It is also interesting to observe that as in the case of Japan the Korean government did not encourage multinational investment.

An important argument of orthodox thinking is the suggestion that most LDCs lack the institutional capacity to implement the State-directed industrialisation such as in Japan or Korea. This argument is plausible, but not necessarily valid. The important point to note here is that the Japanese model was itself imitated by Korea and Taiwan. When Korea decided to embark on the Japanese model in the 1960s, as World Bank economists themselves admit, Korea did not have the necessary institutional capacity. The bureaucracy of Korea suffered at the time from a lack of skills and a deficit of competition ethos, as was indeed the case with the Kuomintang bureaucracy in Taiwan. Yet these countries were able to create the right kind of bureaucratic structures required and other institutions necessary for implementing the Japanese model. If these institutions could be created by Korea and Taiwan, and later on by Malaysia or Indonesia, surely it must be possible to establish them as well in many other MICs?

8. South-South and North-South cooperation

A fundamental argument of this workshop is that developing countries have much to learn from each other. There should therefore be south-south cooperation and collective learning from developing countries' own experiences. The scope for such learning and its potential benefits are enormous. Several models are available and can be useful. Specifically, developing countries can follow the OECD model, which brings together the top civil servants from various countries in any particular specialist area (say transport or food-grain distribution) for an exchange of views on optimal policy formation and implementation. Such meetings can be held at higher ministerial level as well as at lower levels. This is by no mean the only method of achieving cooperation between the MICs. There are variety of other methods involving education, science, technology among other fields which can also contribute greatly to mutually beneficial cooperation and exchange. I end this brief presentation by noting an extremely important point that the south-south cooperation is not intended to replace north-south cooperation but rather to supplement it with other useful types of collaboration.

Notes

1 These examples of World Development Report (1991) and the Béla Balassa observations for 1988 either post-date or are about the same time as Amsden's book of 1989. However, the point about citing these particular reports is to indicate the general atmosphere of the times and the debates which were current, and a year or two difference on either side does not alter the substantial point. Further, these reports are the best and most representative of their kind.

2 See Singh (2012).

3 The Japanese government pioneered these policies, which were a part and parcel of that country's industrial policy.

4 See Singh (1995) and Amsden (1989) for fuller analysis of this point.

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