

THE KEY  
TO THE  
ASIAN MIRACLE

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Making Shared Growth Credible

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## Four

## Wooing the Business Sector

TO ACHIEVE their economic goals, leaders in the high-performing Asian economies needed to win the support and cooperation of economic elites. Without the investment and expertise of these groups—by definition the wealthiest and better-educated members of society—HPAE leaders would not have been able to achieve sustained, rapid, and relatively equitable growth. Winning and keeping the support of these groups without compromising necessary economic policies was tricky. To do so, leaders had to avoid a common mistake of dictators: fearful of losing power, a typical dictator prizes loyalty and gives high priority to preserving it.<sup>1</sup> Rather than encourage competition, for example, dictators grant monopolies to businesses that can be relied on to repay the favor by supporting the dictator—and often by sharing part of the proceeds. Thus dictators typically build loyalty, and enrich themselves, by tying the fortunes of those who control economic resources to those of the regime.

A typical dictator rewards his followers with assets taken from those who refuse to profess loyalty or who have been associated with a political rival. Inevitably economic decisions become embroiled in political machinations; economic rivalry is resolved in the political sphere, as insiders use their influence to hinder their competitors. The privileged insiders will be depicted as patriots as long as they do the dictator's bidding. But they know if they become too wealthy they, too, may become targets. Because the ruler enforces his will with threats, his followers fear that their good fortune can be rescinded at any time. Those who benefit from largess today know that the ruler's promise not to harm them in the future carries little credibility: because the dictator is above the law, his promises are unenforceable.<sup>2</sup>

1. Tullock (1987); Wintrobe (1994).

2. Root (1989, 1994); Weingast and North (1989).

This uncertainty about the ruler's future behavior induces firms to be secretive. Firms know that their assets can be confiscated, so they attempt to keep them hidden. Rather than register their assets, firms hide accounts and expatriate capital to safe havens abroad. Similarly, investors hesitate to put their capital at long-term risk. They therefore prefer trade activities or activities with a short time horizon to the long-term investments in fixed assets that are necessary to build up industrial capacity.

Frequently, a dictator's subjects attempt to protect themselves from censure by making the dictator feel admired. They therefore provide the dictator only with the information he wants to hear.<sup>3</sup> The more power the dictator accumulates, the less willing his subjects are to risk disclosing unpleasant information. For similar reasons, government officials will avoid delivering bad news or reporting activities that run contrary to the expectations of the ruler. Lacking a method to learn about the impact of a given policy from those most directly affected, most dictators are unable to formulate effective economic programs.

Despite the violent origins of the political authority held by many of the HPAE leaders, this all-too-familiar scenario clearly does not apply to East Asia's high performers. Indeed, some observers have suggested that the East Asian economies succeeded precisely because the region's leaders were relatively unconstrained by institutions in the choice and implementation of government policy. In this view, authoritarian rule was not a hindrance but an aid to sound economic policy.

This chapter and the next offer a different hypothesis about the institutional foundations of East Asia's success. We argue that the East Asian leaders secured the support of economic elites without compromising sound policy through mechanisms designed to facilitate consultation, cooperation, and coordination.

To understand what East Asian leaders did, it is useful to look more deeply into the problems that beset authoritarian leaders. A dictator, by his nature, does not generally entertain checks (and balances) against his authority. But this absence undermines credibility for the long term: how do firms know he won't change policies tomorrow? If dictators want information to determine the appropriate choice of policies, they must ensure that the disclosure of information will not result in the direct (through expropriation) or indirect (through adverse changes in

3. Wintrobe (1994).

policies) confiscation of assets. To solve this commitment problem and to institutionalize the flow of information between the private and public sector, East Asian leaders traded authority for information, in effect tying their own hands by establishing institutions that restricted their scope for arbitrary action. Their design of institutions to limit sovereign discretion is rich in implications for the governments of other developing nations, including those governed by democratic constitutions.

The need to gain the cooperation of the economic elites illustrates the importance of institutions that facilitate the exchange of information between the public and private sectors. Each of the high performers had to overcome leadership's credibility deficit in order to win the confidence of those groups that had the capability, knowledge, and capital to build a dynamic industrial sector. One critical but often overlooked institutional device to achieve this is consultative committees, which five of the successful Asian economies—Singapore, Thailand, Korea, Japan, and Malaysia—have used.<sup>4</sup> In these countries, these committees, sometimes called deliberation councils, have been active and often critical in the formulation of policies, rules, and regulations that eventually govern a sector, industry, or in some cases the macroeconomy.<sup>5</sup>

### The Deliberation Council

A deliberation council consists of representatives from the private sector and public sector.<sup>6</sup> The constitution of its membership depends

4. Although consultation processes have also permeated policymaking in Hong Kong, they have not been extensively documented. The process of consultation in Hong Kong begins at the executive council, which in 1986 consisted of five ex officio high government officials—the governor, the chief secretary, the financial secretary, the attorney general, and the commander of the British forces—and ten nominated members who do not hold public office. Although formally empowered to override advice given by members of the executive council, the governor is unlikely to do so as he depends heavily on the cooperation of nongovernmental council members for their contacts among the broader community. The executive council as well as the legislative council, the urban or regional councils, the district boards, and the many advisory boards and committees appointed by the government all depend on private sector participation.

5. We should note that the councils described here should not be equated with the *deliberative* councils in Japan. Many of the Japanese councils perform perfunctory roles and do not possess the fundamental characteristics that make a deliberation council effective. Only some (and these tend to be the more important ones) such as the industrial structure council are consonant with our concept.

6. Councils are not the only mechanism through which business and government interact. Many informal devices permeate this interaction. But councils are the most

on the policies over which it deliberates. For example, a council formed to discuss regulations governing the electronics industry would include representatives from the biggest electronic firms. If the industry has an active association, several members of the association would normally act as representatives. It would also include several midlevel and senior bureaucrats from the ministry of trade and industry. A council established to discuss international trade policy, however, would be larger and would enlist representation from all major industries and from many more government ministries. It may also include representatives of labor and consumer groups and is likely to be chaired by the deputy prime minister, if not the prime minister himself.

Generally the deliberation council has a quasi-legislative authority, and policies cannot be introduced or changed without its recommendation or approval. In this sense, it is like a legislative committee in a typical western democracy. But unlike a legislative committee, its private sector representatives are not selected by the electorate. Instead they are chosen by their respective sectors, for example, industry or labor. Its government officials become representatives by virtue of appointment. The principal task of a council is to assist the government in formulating policies that would enhance the performance of a particular segment of the private sector (if not the private sector as a whole). Within this context, a council is designed to reduce the high transaction costs of coordination; to overcome asymmetric information and rent seeking; to stabilize the policy environment; and to legitimize economic policies. More specifically, its cooperative format reduces the cost of obtaining and transmitting information about the design, implementation, and modification of existing policies. Second, it provides private sector participants with a transparent forum in which to bargain over the rules that determine how rents are to be allocated. Thus it diminishes the importance of patron-client relations and reduces the need for lobbying. Third, it gives the government a mechanism to instill confidence among investors that policies will not be altered without appropriate consultation and support from the private sector. Thus government can credibly commit to policies that enhance private sector development. And fourth, private sector participants gain a forum to express their views about policies that affect their industry and to

visible and can be documented more easily. Furthermore, agreements between the two parties are formalized in councils.

have those views incorporated into the formulation or alteration of the policies. Thus councils create a channel for government to establish the legitimacy of the policies it promulgates and implements. Councils vary by country and sector in the relative importance they assign each function.

### National Wages Council: Singapore

Singaporean independence was marred by worker and student unrest. Tensions between labor and government had a long history. As discussed earlier, leadership understood that resolving labor tensions was critical if Singapore were to enjoy the prospect of development. Aggressive efforts to attract multinational corporations were the main feature of Singapore's development strategy. But multinationals have generally been hesitant to move their labor-intensive operations to countries with an unstable labor regime or an uncertain policy environment. The People's Action Party (PAP) thus focused on facilitating cooperative business-labor relations to help stabilize the policy environment. An important component of the strategy was the creation of the National Wages Council (NWC).

As noted earlier, the NWC is a tripartite advisory body composed of government, employer, and labor representatives. Multinationals are also represented. Each year the council reviews the past performance of the economy and evaluates prospects for the coming year. Based on the findings, members deliberate on employment-related issues generally and specifically on the appropriate guidelines for the year's wage increases. A key feature is tying the increases to gains in productivity, estimates of which are based on the past and projected performance of the economy. Meetings are held in the first half of each calendar year. Public views are sought for each year's deliberations although the deliberations themselves are kept private. Meetings follow two working rules, the Chatham House rule on nonattribution and the decision rule of unanimity. Under the Chatham House rule, statements and comments made by members are not to be publicly attributed to any individual. The rule thus promotes a freer discussion of the issues. Unanimity requires that each of the three groups—government, labor, and business—must support the proposed guidelines. Deliberations continue until all three agree to the provisions. Once an agreement is

reached, the agreed-on guidelines are announced to the general public. The council's recommendations are nonbinding but, largely because of the unanimity rule, both business and labor have accepted them as an impartial benchmark of a reasonable wage settlement achieved through compromise. The government has always accepted the guidelines and usually is the first to adopt them.

The NWC incorporates all four functions of a deliberative council. It has been the primary channel through which government and the private sector share market information, especially information on improvements in productivity and trends in global markets. Orderly wage increases have resulted from its deliberations: (quasi) rents are allocated transparently and objectively between business (profits) and labor (wages).<sup>7</sup> Both labor and business have been granted veto power over wage policy (via unanimity) and thus have had real input into the decisionmaking process. In effect, the council resembles a legislative committee with limited jurisdiction. And finally, precisely because of its veto power, the council has helped maintain order and stability in wage negotiations, providing assurances to business and labor that wage policies will not be reversed arbitrarily or forcefully, for example, through strikes.

The unanimity rule has resulted in the implicit devolution of authority over employment policies by the government to the NWC: unanimity has assured each party that employment policies cannot be altered without their consent. By granting the council this authority over employment policies, the government has imposed on itself a very high cost to changing employment policy "from above." Forcing such a change could undermine the growth process since, fearing the onset of arbitrary policymaking, businesses may decide to move out and labor may decide to resort to more disruptive expressions of its demands. Should any of the parties take unilateral actions that challenge the council's legitimacy or jurisdiction, they would reduce the future value of the council as an instrument for coordination, consent, and commitment.<sup>8</sup> In short, the council has given the government the capacity to credibly commit to a stable, rational policymaking process.

7. Quasi rents are to be interpreted as gains over and above marginal cost.

8. There is a related argument that has permeated the study of American politics. One of the principal theoretical results of positive theories of U.S. congressional politics is that legislative institutions, for example, the committee system and its associated rules,

*Japan*

As a democracy with a free press and an established tradition of freely electing the legislature, Japan is unique among the high performers. However, like Singapore, it has made extensive use of deliberation councils. Its experience thus highlights the potential adaptability of a council system to different political circumstances.

After World War II the newly formed legislature earned its legitimacy as representatives of the people; the bureaucracy, however, was held over by the occupying forces and lacked a comparable claim to democratic legitimacy. Moreover, owing to the demise of the military as a political force and being the only surviving institution from the prewar era, the bureaucracy had become powerful.<sup>9</sup> Thus, although a parliamentary democracy, Japan's government had a credibility problem. It was dominated by a single party, which had at its service an administrative apparatus (imposed by the occupying forces), which did not have a democratic mandate and yet could intervene directly in the economic decisions of the private sector. To remedy this condition, councils were introduced and were especially important during the first two decades of Japanese democracy as a method for the bureaucracy to break with the past. In dealing with the Diet (the Japanese parliament), councils allowed the bureaucracy to make a claim to being representative of a constituent group.<sup>10</sup>

Among the HPAs, Japan's councils are the most well developed

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enable legislators to exploit gains from trade—vote for my project and I will vote for yours—which otherwise would not materialize because of majority rule vote cycling. Legislators, it is argued, support the maintenance of such institutions precisely because it allows them to exchange votes in ways that make everyone better off (for a concise explanation, see Shepsle and Weingast [1994]), that is, they allow bargains to be struck and to stick. In the context of the NWC, each party gains from having the NWC function as it has. The government manages to attract and keep investment, especially foreign investment, in the country; labor is assured that wages will track productivity gains and will be applicable to all workers; firms, especially multinationals, can be certain of a stable work environment. Hence, each party has incentives to keep the NWC as is.

9. Johnson (1982).

10. This would inevitably mean that bureaucrats would have to show the consensus of the relevant council before bringing a policy up for parliamentary approval. See chapter 6 for an extensive discussion.

and widely recognized. However, they are also the least transparent.<sup>11</sup> The Japanese deliberation councils included private sector representatives from the large industrial sector and in some cases from labor and consumer groups. Two categories of deliberation council allowed the Japanese government and private industry to cooperate on economic policy since the late 1940s. The first type is organized along functional or thematic lines, for example, industrial rationalization, pollution, and finance; the second is organized according to industry or sector, for example, iron and steel, automobile, and chemical. The councils are established by a government ministry and are formally associated with specific bureaus within that ministry. Table 4-1 lists the councils attached to the Ministry of Trade and Industry (MITI). The Industrial Structure Council, the Industrial Property Council, the Export and Import Transaction Council, and the Industrial Technology Council are examples of the first type. The Mining Industry Council and the Textile Industry Council are examples of the second. A functional deliberation council is normally divided into special committees. As shown in table 4-2 the Industrial Structure Council, one of the most influential during the 1960s, had eighteen such committees, each consisting of representatives from government and the private sector. Table 4-3 identifies the composition of the Industrial Structure Council.

Figure 4-1 illustrates the typical process involved in the formulation of policy in MITI. In the initial stage, MITI calls a hearing and invites various parties to participate. It compiles the data and integrates the results of the hearings into a draft. The draft report goes to the appropriate research group in MITI, which then prepares a report for discussion in the appropriate council. In the council, the views of industry officials, academics, consumers, and other interested parties are solicited and incorporated into a plan. The research group then makes changes to the report based on the feedback from council members. The last stage of the process resembles an advertising campaign through which MITI explains to the general public the objectives and reasons for the new policy.

As in Singapore, a Japanese council is essentially a forum through which government officials and representatives from the private sec-

11. Much of the information is contained in files of MITI to which access is limited. The discussion presented here comes from background papers by researchers in academia and government and from interviews with Japanese academics and government officials.

TABLE 4-1. Major Regular Deliberative Councils Attached to MITI, 1990

Council name	Affiliated bureau or agency	Date founded
Commodity Exchange Council	Industrial Policy Bureau	1950
Export and Import Transaction Council	International Trade Administration Bureau	1953
Coal Mining Council	Agency of Natural Resources and Energy	1955
Mining Industry Council	Agency of Natural Resources and Energy	1962
Small and Medium Enterprise Policy Making Council	Small and Medium Enterprise Agency	1963
Industrial Structure Council	Industrial Policy Bureau	1964
Textile Industry Council	Consumer Goods Industries Bureau	1964
Electricity Utility Industry Council	Agency of Natural Resources and Energy	1964
Industrial Location and Water Council	Industrial Location and Environmental Protection Bureau	1966
Industrial Property Council	Patent Office	1966
Data Processing Promotion Council	Machinery and Information Industries Bureau	1971
Industrial Technology Council	Agency of Industrial Science and Technology	1973
Large-Scale Retail Stores Council	Industrial Location and Environmental Protection Bureau	1974
Chemical Product Council	Basic Industries Bureau	1974
Traditional Craft Industry Council	Consumer Goods Industries Bureau	1974
Petroleum Council	Agency of Natural Resources and Energy	1978
Aircraft Industry Council	Machinery and Information Industries Bureau	1986

Source: Japan Development Bank and Japan Economic Research Institute (1993).

tor—industry, academia, the press, and in some instances, labor—exchange views on policy matters, discuss trends in markets and products, and more generally, share information.<sup>12</sup> The councils have provided the government the means to create a consensus on a particular policy matter: when the council does not agree on a policy, it is unlikely

12. Extensive informal information networks supplement the meetings of the deliberative council.

TABLE 4-2. Committees of the Industrial Structure Council

Committee name	Main items of deliberation	Year established
Central Committee	Basic direction of overall industrial policy	1964
Distribution Committee	Survey the actual state of distribution system and basic issues with respect to its modernization	1964
Industrial Pollution Committee	Measures to cope with industrial pollution	1964
Industrial Fund Committee	Formulating appropriate annual capital investment plans from the viewpoint of upgrading the industrial structure and strengthening international competitiveness; formulating plans for procuring necessary funds	1964
Management Committee	Financial, labor, and production management	1964
Cinema Committee	Liberalization measures and promoting exports	1964
Nuclear Power Industry Committee	Development of nuclear power and related businesses	1964
Energy Committee	Comprehensive energy policy	1964
International Economy Committee	Understanding and taking measures for the direction of the international economy, focusing mostly on the North-South problem, East-West problem, and problems of advanced industrialized nations	1964
Consumer Economy Committee	Analysis of the consumption structure and providing for a sound consumer life-style	1964
Heavy Industry Committee	General measures for promoting the machinery industry; analysis of the market for heavy industrial products and measures to promote exports	1964
Chemical Industry Committee	Measures to guarantee long-term supplies of naphtha for the petrochemical industry; analysis of the export market for chemical products and measures to promote exports	1964
General Merchandise and Construction Materials Committee	Grasping the current state of the general merchandise distribution system and formulating measures for the future; measures to promote the export of general merchandise; survey of the current condition of the gravel supply; basic direction of the pre-fab industry	1964

TABLE 4-2. (continued)

Committee name	Main items of deliberation	Year established
Textile Committee	Grasping the actual condition of the distribution system for textiles and policies for its normalization	1965
Industrial Finance Committee	Industrial finance policies for normalizing finance, consolidating equity, and upgrading the industrial structure	1965
Industrial Labor Committee	Measures for the effective application of industrial labor potential	1965
Industrial Location Committee	Appropriate placement of industry; preparing the conditions for locating industry	1966
Industrial Technology Committee	Measures to strengthen the development of technology	1965

Source: Japan Development Bank and Japan Economic Research Institute (1993).

the policy will be approved by the legislature even if it is supported by the bureaucracy.

Hence, it was important for MITI to achieve consensus within the deliberation council, for it is here where success or failure of a policy initiative was essentially determined. For example, "the plans for the concentration of the automobile industry, which in fact never materialized, were both strongly opposed at the council level. In the end a consensus within the industries concerned was not obtained."<sup>13</sup> Three times MITI proposed rationalization of the auto industry. The first national car plan basically gave the rights of production to a single winner. In 1955, MITI formulated the National Car Project and attempted to execute it, its purpose being concentrated production of low cost, small cars for the general public by a single manufacturer. . . . The Concept concerned a car accommodating (1) four passengers (2) costing about 250,000 yen (3) with a displacement of 350 to 500 cc (4) weighing 400 kg, and (5) with a maximum speed of 100 km/h. Concentrated production of this car by a single manufacturer was proposed.<sup>14</sup> The second was a partitioning of the industry into three groups, each group producing a specific vehicle cate-

13. Japan Development Bank and Japan Economic Research Institute (1993, chap. 2, p. 42).

14. Itoh and Urata (1993, p. 14).

TABLE 4-3. Composition of Industrial Structure Council

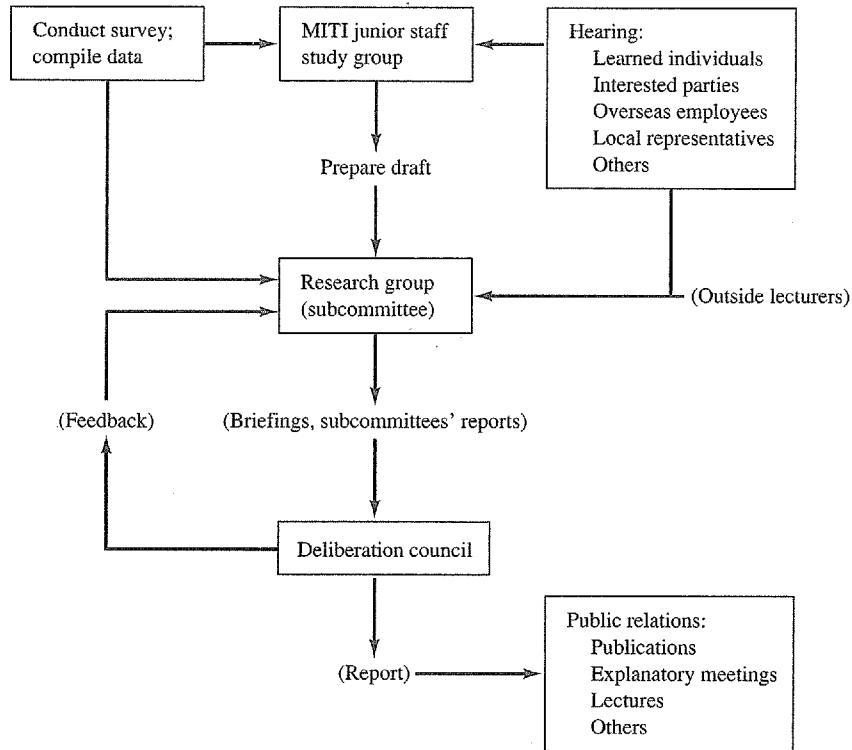
<i>Industries and business representatives (20)</i>	<i>Academics (7)</i>
Japan Committee for Economic Development, secretary general	National University, professor
Japan Chamber of Commerce and Industry, managing director	National University, professor
Osaka Chamber of Commerce and Industry, president	Private university, professor
Kansai Economic Federation, chairman	Private university, professor
National Federation of Small Business Associations, chairman	Private university, professor
Synthetic fiber company, president	Economic commentator
Chemical company, honorary president	<i>Journalists (2)</i>
Chemical company, president	Newspaper advisor
Petroleum Association of Japan, president	Broadcast station analyst
Oil company, advisor	<i>Consumer and labor representatives (3)</i>
Steel company, chairman	Consumer association, director
Electronics industry association, chairman	Labor association, director
Electronics industry promotion association, chairman	Labor association, director
Electrical manufacturing company, president	<i>Financial representatives, others</i>
Electrical manufacturing company, president	City bank, chairman
Automobile industry association, chairman	Long-Term Credit Bank, chairman
Retail company, chairman	Japan Development Bank, governor
Retail company, president	Shoko Chukin Bank, president
Railway company, president	Prefectural Governor
Federation of Electric Power Companies, chairman	National Mayor's Association, chairman
Electric Power Company, president	Total 42
<i>Former bureaucrats (4)</i>	
Think tank, managing director	
Think tank, managing director	
Think tank, managing director	
Japan Foreign Trade Council, chairman	

Source: Management of Coordination Agency; Japan Development Bank and Japan Economic Research Institute (1993).

gory. "In May 1961, MITI proposed to split the automakers into three groups of mass production, special passenger cars (high class cars and sports cars), and mini passenger cars, each group consisting of two to three manufacturers."<sup>15</sup> Both times, council members rejected MITI's

15. Itoh and Urata (1993, p. 15).

FIGURE 4-1. Industrial Vision Formulation and the Deliberation Council



Source: Ono (1992).

proposals. And both times, MITI resisted forcing the issue in the Diet. In its third try, MITI managed to obtain a consensus among the manufacturers. Import protection was agreed to in exchange for exporting: every manufacturer could participate.<sup>16</sup> Shortly thereafter the Diet (the legislature) passed a new automobile industry rationalization law embodying the agreement.

The auto industry example illustrates two functions of a council. First, transparent rules for the allocation of rents among firms were established. Manufacturers agreed to a plan that gave each one opportunities to earn rents through protection of the domestic market in exchange for successful expansion into export markets. Second, while

16. Itoh (1993).

providing inputs into legislation, manufacturers had veto power. As a consequence, automobile manufacturers could be confident that policies would not be changed without their consent and therefore were relatively durable.

Why does government not overturn those council decisions it opposes and abide only by those it prefers? The answer is rather subtle. Given that councils have permeated many industries and sectors in the country, by unilaterally imposing its will on a single industry or sector, the government risks undermining the value of councils and thus subverting the whole system of cooperative decisionmaking. This in turn would increase the transaction costs of policymaking and thus could retard economic growth.<sup>17</sup> Should that happen, the legitimacy of the government could be more easily challenged. Tying the fortunes of many groups to the continued use of a particular system raises the cost of altering that system. Hence, the more closely groups are tied together, the more credible a system becomes. By institutionalizing councils, the government has limited its discretionary power over economic policy but in turn has created an environment that has given big business confidence in the stability of policies agreed upon.

### Korea

Rebuilding private sector confidence was a priority for an obscure group of military officers who violently took power in Korea in 1961. Those officers were willing to place all political bets on economic growth. After first shattering existing old-boy networks, they struck a deal with the heads of the big conglomerates (chaebols) they had imprisoned: the private sector would deliver development and, as part of the bargain, confiscated wealth would be released. After this initial heavyhandedness, consultation between government and the chaebols greatly helped to win back private sector support. Political leaders helped to coordinate private sector effort but left the actual work to the business community.

In Korea from the mid-1960s to the early 1980s, government and private sector relations were characterized by frequent, regular meetings between leaders of both groups. These meetings were less formal than the council meetings in Japan or Singapore, but they had similar objectives: information exchange; rent allocation; elite participation in

17. This argument is derivative of Grief, Milgrom, and Weingast (1994).



policymaking; and stability of the policy environment. President Park Chung Hee's presence at monthly export promotion meetings gave authority to the meetings.<sup>18</sup>

The meetings were the barometer for the country's export push and thus critical to its overall economic performance. The ministries' commitment to building up the private sector went as far as bullying it into accepting export markets.<sup>19</sup> However, bureaucrats did not decide what to produce. Rather they coordinated and ensured the sharing of relevant information among all parties that had bargaining power, specifically, big business. These meetings and the informal consultations that followed facilitated early recognition of problems encountered in expanding Korean export markets. The primary focus of these meetings was the joint determination of export targets for various industries by private enterprises and government officials. The Ministry of Commerce and Industry collected information from individual exporters on a monthly, weekly, and sometimes even daily basis. It also monitored and analyzed changes in market conditions. Export targets and policies were altered when necessary so that the government and private sector could respond rapidly to fluctuations in world markets. Short-term changes in government policies could then reflect world market conditions. The system reduced the risks to private enterprise of engaging in export activity.

Lower-level meetings between middle managers in private industry, mid-level officials in government, and experts and scholars supplemented the monthly export promotion meetings. Meetings took place in the form of industrial discussion groups. There were basically two types: the functional (for example, taxation) and the sectoral. The former was centered around the presentation of various viewpoints from known experts on topics normally identified and chosen by the bureaucracy, for example, the Ministry of Finance. The experts provided their analyses and opinions; the government bureaucrats normally just listened. Though the final decision was made by the bureaucracy, the

18. "The establishment of this well-publicized meeting had a significant effect in exploring profitable markets and in implicitly promising government-wide support for private sector activities designed to achieve those export targets." Chang (1992).

19. Samsung lost a fertilizer factory when it refused to support Park's initiative. This confiscation, however, was conducted according to rules: the stick was applied when the company refused to cooperate. This information is based on an interview with Professor Bong-Joon Yoon in October 1992.

policies adopted generally attempted to incorporate the various viewpoints. The second type of industrial discussion group involved representatives from an industry, usually from the corresponding industrial association, who discussed their perspectives on an issue with representatives from the Ministry of Trade and Industry. At this level, the process was primarily one of gathering information rather than collaborative decisionmaking. Nevertheless, vocal industry representatives often helped shape the final product.

Deliberation councils, especially the monthly export promotion meetings, were important in coordinating the export drive. During the meetings, obstacles to achieving competitiveness were discussed and solutions were often recommended and implemented.<sup>20</sup> The meetings presided over by Park were devoted to monitoring export targets and solving export-related problems. The criteria for access to subsidized credit and to production licenses became more transparent as a result of the councils. Firms seeking credit and licenses had to meet Park's basic criterion: "How much have you exported for me lately?"<sup>21</sup> Export performance was used to allocate preferential credit and to determine who would get valuable licenses from the government to produce promoted products.<sup>22</sup> The council's principal function was to extract the necessary information to formulate better export promotion policies and to allocate rents, that is, credit subsidies and production licenses, in a systematic, transparent, and objective fashion.<sup>23</sup>

20. Amsden (1989).

21. Amsden (1989) refers to this system as reciprocal exchange.

22. The meetings were designed to be genuine dialogues between firms and the government. Participants were chosen by business associations. Moreover Park made a policy of never meeting with representatives of firms privately. He met with business people in groups and as representatives of their industry, not their particular firms (interview with Chang-Yum Kim, January 1995). In this way, rent allocation was based on transparent and objective criteria.

23. Exporting, which began in the more neutral environment of the 1960s, continued to be a major criterion for allocating credit during the 1970s. Export promotion consisted not only of preferential credit but of other policies as well. See Rhee and others (1984) for a comprehensive review of Korea's export-promoting policies. Enforcement of the performance criteria was possible because the government possessed strong leverage over firms: it controlled the sources of loans, for example, banks, and the authority over industrial licensing. Haggard (1990); Amsden (1989). As Wade (1990) notes, the debt-equity ratio of firms in Korea has been historically higher than in Japan or Taiwan, suggesting that much of the firms' initial growth was debt driven. Since loans often had to be rolled over, the threat of terminating loans could jeopardize the existence of highly

Once established, the country's export orientation was difficult to alter. Firms had come to expect significant rewards for success in exporting and thus had oriented their production, management, and marketing capabilities to world markets. Changing the rules of the game would have had serious consequences on firms' operations and thus on economic growth, undermining the legitimacy of the military government. The councils in Korea helped make export policies durable and credible to the private sector, coordinating the move from an inward-looking, protectionist trade regime to an outward-oriented one, institutionalizing a process that made exporting virtually irreversible.<sup>24</sup>

### Thailand

Before 1981, Thailand's relationships between the public and private sectors were characterized by "a prevailing sense of distrust, and elements of arrogance on both sides. The public sector regarded the private sector as selfish entrepreneurs and thinking only of their personal profits with little sense of social responsibility. The private sector, on the other hand, suspected government officials of being extremely inefficient, corrupt, and bureaucratic. . . . The two points of view were rarely reconciled as there was no formal mechanism to bring about more fruitful dialogues."<sup>25</sup> The sources of the mistrust had deep historical roots. Since the turn of the century many commercial enterprises have been controlled by the Chinese minority causing the majority native Thai to perceive them as capitalist exploiters. From the overthrow of the monarchy in 1932 to the late 1970s, under successive governments, mostly military, the public sector was the exclusive domain of native Thai counteracting the economic power of the Chinese. As a result, business-government relations had come to be governed by military-bureaucratic *clientilism* (that is, a relationship in which

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leveraged firms. In some cases, the government refused to bail out failing companies unless the firm agreed to changes in the management.

24. Irreversibility is related to the concept of path dependency. Path dependency refers to historical constraints imposed on the trajectory of an economy. For example, David (1985) argues that the initial development of the QWERTY keyboard for the typewriter has constrained the adoption of more efficient keyboards primarily because the former has come to be accepted and used by a very large number of people and establishments. Changing to a new system would involve enormous coordination. Irreversibility stems largely from the costs of coordinating a switch.

25. Muscat (1994, p. 183).

public officials are "patrons," providing some protection or security from harassment to private business groups who are "clients."<sup>26</sup> To protect their business interests, the Chinese resorted to "outright bribery or [sought] patron-client relationships with the military-bureaucratic leaders, mainly by inviting the latter to join executive boards or to hold stock in companies at no cost."<sup>27</sup> The presence of military-political leaders on the boards of twelve of Thailand's sixteen commercial banks in 1972 illustrates the extent to which this protection system was institutionalized.<sup>28</sup>

But although the protection system allowed economic activity to flourish, it failed to alleviate the basic mistrust between the public sector and the private sector. Entrepreneurs presumed (correctly) that they needed strong patrons in government to prevent harassment. Bureaucrats and military officers had come to expect board memberships in exchange for their consent to and protection of commercial activity.

In the early 1980s, partly to help overcome the tradition of mistrust, the orchestrators of Thailand's liberalization drive championed the need for better and more formal communication between the public and private sectors. Designating the private sector as the engine of growth, the Prem government's Fifth National Economic and Social Plan proposed a mechanism for public and private sector collaboration. "The National Joint Public and Private Consultative Committee (JPPCC) was formed, with the Prime Minister as Chairman and the Secretary General of the National Economics and Social Development Board (NESDB) as Committee Secretary. Other members were the deputy prime ministers, ministers and deputy ministers of economic ministries, the Governor of the Bank of Thailand and the Secretary General of the Board of Investment. The private sector was represented by three representatives from the Thai Chamber of Commerce (TCC), three from the Federation of Thai Industries (FTI), and three from the Thai Bankers Association (TBA)."<sup>29</sup>

26. Clientilism refers to the personalized pairing of partners in recurrent exchanges. Ties are developed to cope with the cost of contract uncertainty. Thus promises are likely to be honored despite the absence of a public enforcement authority, and social or political rank will heavily influence the terms of trade.

27. Laothamatas (1988, p. 451).

28. See chapter 5. Business-government relations in pre-1981 Thailand share many of the features of the relations in post-1965 Indonesia.

29. Samudavanija (1992, p. 26).

In Thailand much of the initiative to establish peak industrial associations came from the private sector, for example, TCC, FTI, and TBA. Although the government legally chartered these bodies, it did not intervene extensively in their development and management.<sup>30</sup> Hence, in contrast with their status in other corporatist states, industrial associations evolved more independently of government in Thailand than elsewhere.<sup>31</sup>

The industrial associations enabled businessmen and bankers to develop their own networks and to participate with the military-bureaucratic elites in the task of developing the economy. This partnership took a new face in the early 1980s as Thailand attempted to recover from the impact of the second oil crisis. In 1981 General Prem, who headed the government from 1980 until 1988, sought the assistance of the private sector to help stimulate the Thai economy. The quadrupling of oil prices increased the balance of payments deficit to alarming levels. Prem asked the representatives of the peak industrial associations for help in addressing the external deficit problem. The creation of the JPPCC, where development policies could be discussed jointly and openly by high-ranking government officials and private sector representatives was their response to Prem's request. With the active support of government technocrats, their recommendation became a reality.<sup>32</sup>

30. "Weak as they might have been as interest groups, business associations were at that time (circa 1970) much stronger than any functional group. . . . Almost all of them were created and/or sponsored, and closely controlled by the government for security and agricultural development purposes. . . . By comparison, business associations were largely independent of the government. . . . No public officials sat on the executive boards of business associations. Official control of their operation, internal regulation, and leadership selection, though harsh in theory, was mild in practice. No closures of associations or bans on their functions or leadership selections had been reported." Laothamatas (1992, pp. 31-32). The impetus for the JPPCC came from the combined efforts of prominent members of the business community with proactive support from technocrats, particularly from Dr. Snoh Unakol, Secretary General of the NESDB during most of the 1980s.

31. Military-bureaucratic governments often create corporate bodies to represent key sectors of the polity and then control these bodies by designating the representatives. This is generally referred to in the literature as *bureaucratic corporatism* (see, for instance, Staniland (1985, chap. 4).

32. The NESDB and in particular, its director, Dr. Snoh, convinced the government to establish the JPPCC. Laothamatas conjectures that Prem may have given serious thought to creating the JPPCC, which the peak associations had long been clamoring for, in order to establish an alternative base of political support. In 1980 he barely survived an attempted coup by so-called Young Turks in the military. Laothamatas (1988).

To contain if not resolve the balance of payments problem, the Prem government recognized that Thai firms had to export. But to export successfully, firms had to be internationally competitive. Hoping to reinvigorate the economy, the Prem government adopted the recommendations of the JPPCC. Through the JPPCC, information about the impact of regulations, tax measures, and trade policy on the performance of firms and more generally on the economy was transmitted back to officials more quickly, thereby focusing the government's response to problems. Moreover, various industrial conglomerates were able to express their concerns over trade policy and to have those concerns addressed in a transparent (to members) forum. Big business was incorporated into the policymaking process, especially trade policy.<sup>33</sup>

But perhaps the most important contribution of the JPPCC was the reduction of bureaucratic clientelism through the creation of an alternative, more transparent system of rent allocation. The need to minimize the adverse consequences of bureaucratic clientelism was one of the principal motives for the Thai technocrats to actively support the creation of the national JPPCC. The principal sponsor among the technocrats, Snoh Unakol, had a very clear position on this matter. "In Snoh's view, Thailand had been close to the decadent model of capitalism. Government-business relations in the past had served only those few who had massive financial resources or good personal connections with high officials. These relationships created resentment among the business community, as well as the general public. . . . Snoh's proposal for government-business dialogues was guided considerably by his conviction that a new system must be built in which under-the-table dealings were reduced by the availability of on-the-table consultation, by the government's responsiveness to the legitimate requests of business, and by the deregulation of the economy."<sup>34</sup> Similarly, Robert Muscat explains that the experience "and the whole arrangement based

33. In some developing countries where big business dominates, trade policy has generally had a protectionist character, for example, in the HPAs, government has dominated the private sector by controlling the extent to which the private sector participates in decisionmaking. Historical factors are responsible for the difference. See, for instance, Hutchcroft (1991) and McCoy (1993) on the Philippines, Haggard (1990) on Korea, and Amsden (1979) on Taiwan.

34. See Laothamatas (1992, p. 82). In interviews, a business tycoon who is a member of the Malaysian Business Council and a senior fellow of a local think tank raised similar points.

on organizations, issues, and transparency, rather than inside dealings and the pursuit of individual commercial advantage, would promote the 'maturation' of the Thai business sector and contribute to the reduction of particularistic or corrupt relationships between business and officialdom."<sup>35</sup> An important component of the business sector's maturation was the acquisition of "a professional capability for open policy discussions." Some of the leading associations commissioned research teams to persuade the government with analytical data. Among others, this included contracting with Chulalongkorn University to research the effect of the tax structure on key industries.

The Thai consultative meetings differed from the meetings in Japan and Korea. Only matters of general interest were discussed, that is, problems that applied to a majority of, if not all, large firms. The Thai meetings were also open to the press, which put pressure on the prime minister to respond to business's proposed reforms. Among the innovations that occurred as a result of the JPPCC dialogue were the development of graduate education in modern business management, incentives for family firms to go public by issuing equity, and establishing standards for disclosure. Investment by multinationals was encouraged in joint ventures with Thai firms. The JPPCC was critical in orienting the economy toward manufactured exports. Significant progress resulted toward establishing international competitiveness and modern business practices. In particular, rules, regulations, and tax measures that governed the export of domestically produced or processed manufactured goods were streamlined and rationalized in order to reduce the production costs of manufacturers and to enable them to compete internationally.

Nevertheless, the consultative process in Thailand has been faulted for failure to develop channels for the representation of small farmers and nonunionized labor. The JPPCC does not represent labor, farm, or public enterprises. At the very least, the councils helped the new professional business sector to establish a foothold in the policy dialogue and to challenge the practice of clientelism. It also signaled the government's commitment to professionalism and to international business practices.

The blatant exploitation by the business sector of public officeholders to obtain privileged access to government favors by the (big) business

35. Muscat (1994, p. 183).

sector resurged, however, during the Chatichai (July 1988–February 1991) administration.<sup>36</sup> Although the Chatichai government represented the political ascendancy of business and was democratically elected, it has less successfully advocated consistent business policies than its predecessor. The pursuit of the spoils of office once again disrupted the dialogue for a coherent policy framework.<sup>37</sup>

The shift to an export-oriented economic strategy is perhaps the greatest achievement of the expanded government-business dialogue. But the sources of mistrust have not yet been eliminated. The JPPCC format did not evolve into a framework for close collaboration between business and government characteristic of Japan or Korea. Measurements of transparency and predictability in the regulatory environment still rank Thailand lower than the more advanced high performers—Japan and the four tigers (see chapter 6).

### *Malaysia*

A lack of confidence stymied the collaboration of business with government until the early 1990s, when Malaysia too learned the benefits of formally coordinating the flow of information. There, business-government relations have evolved through three phases: the free market phase (postindependence to 1970); the Bumiputra or New Economic Policy (NEP) phase (1972 to 1985); and transition to the New Development Policy (NDP; 1986 to the present).<sup>38</sup> In phase one, the government basically allowed the private sector to function freely and was primarily concerned with infrastructure building. In phase two, in response to

36. Muscat (1994).

37. Muscat (1994, p. 184) speculates that the JPPCC declined when the Chatichai business cabinet (July 1988–February 1991) made it unnecessary. "The policy and regulatory framework that is the natural subject of interest to the private sector across the board receded into the background as the rivalries among a handful of individual businessmen and groups, then having captured the very mechanisms designed to regulate them and dispense public resources, took center stage. The further evolution of institutionalized relationships between government and business organizations was put on hold as the individual businessmen/politicians and government leadership became one and the same." His conjecture suggests why councils in other parts of the world might not work: if the business community has viable, alternative means for communicating and influencing government, then councils may have less value and thus may not be as highly valued by their members.

38. The New Development Policy was introduced officially in 1991 as the successor to the twenty-year program embodied in the NEP.

the racial riots of 1969, the government introduced the Bumiputra Policy. As discussed earlier, the policy was designed to narrow the wealth gap and enable native Malays to participate in trade and industry by requiring minimum Bumiputra participation in economic activities. During phase three (which roughly coincides with Prime Minister Mahathir's leadership), the antagonism that characterized government-business relations in the second phase was gradually redressed. For example, firms with less than M\$2.5 million capitalization were no longer subjected to the requirement that 30 percent of their stock be sold to Bumiputras. The NEP was transformed into the NDP, in which big business has been given the primary role of leading the development of the country. This thrust characterizes Mahathir's Look East Policy. The first sign of a change was the creation of the so-called Budget Dialogue in which captains of industry were called in to discuss the national budget with finance officials. Then advisory groups for certain sectors were formed. Each group included representatives from industry and government. The members helped formulate policies and developed strategies for implementation. Finally, the Malaysian Business Council (MBC), which included sixty members from private industry, some members of labor, several government ministers and deputy ministers, and the prime minister as chairman, was established. The MBC facilitated direct communication between big business, labor, and the prime minister.

The use of councils dates back to 1981. A confidential government study of business-government relations in the mid-1980s uncovered informal councils tied to government ministries. An informal council basically made evaluations of a ministry's regulations. It was further discovered that a council's effectiveness depended on the participation of individuals from the private sector. Those that had members from the private sector produced output useful to the ministries as well as to the private sector groups the latter regulated: rules and regulations were revised to reduce the burden on the private sector. Those that did not failed to provide useful solutions to problems they were asked to address. These findings largely influenced the formation of the Malaysian Business Council and the Budget Dialogue Group in which private sector representatives participate as active and equal members.<sup>39</sup>

It is still too early to evaluate the effectiveness of the MBC and the

39. Critics point out that labor is not adequately represented in these consultations.

Budget Dialogue Group and to establish exactly what their functions are. Personal interviews with some participants suggest that, like the JPPCC in Thailand, the MBC has helped move rent seeking from covert, under-the-table dealings to more transparent, over-the-table transactions.<sup>40</sup>

### The Implications of Councils for Economic Performance

As the preceding examples illustrate, deliberation councils yield economic benefit.<sup>41</sup> A council serves as a convenient channel for collecting relevant information from, and distributing it to, its participants. It thus improves economic efficiency: it supplements the allocative function of markets by facilitating coordinated responses to changes in economic conditions. A council also helps reduce the opportunities for and welfare losses from rent seeking.<sup>42</sup> Furthermore, a council performs a commitment function, binding sovereign authority to a set of rules governing economic policymaking. Hence, it helps minimize economic distortions attributable to the nonsimultaneity of the costs and benefits of a policy.<sup>43</sup>

#### *Improving Coordination*

Although the HPAEs have all established various mechanisms to reduce the costs to firms and the government of obtaining information

40. Malaysia's most recent advertising campaign to promote business and investment highlights the importance of the MBC to the country's thrust toward achieving Mahathir's Vision 2020. A video featuring the role of the MBC was played for participants at an ASEAN conference on governance in Vietnam in September 1994.

41. Ideally, we would have wanted to link councils with their welfare consequences. Unfortunately, this would require constructing an experiment that would provide measurable criteria. In general, the state of the art in evaluating the welfare impact of institutions is still primitive compared with evaluation in other more developed fields. Campos and Lien (1994) have shown theoretically that councils can reduce the amount of directly unproductive profit-seeking (DUP) activities. See Bhagwati and Srinivasan (1982) for a definition and discussion of DUP activities.

42. That is, it not only reduces the size of the "Harberger" triangles but also the magnitude of the "DUP rectangles." Harberger triangles refer to a measure of efficiency losses and DUP rectangles to a measure of losses from DUP activities.

43. See Rodrik (1989) and Campos and Esfahani (forthcoming) for a discussion of the problem of promises and the lack of credibility within the context of policy reform.

about markets, councils stand out as particularly useful mechanisms to transmit information. Changes in world markets, new trends in technologies, and perverse effects of regulations domestically and abroad are all communicated to the bureaucracy by private sector agents. In turn, the bureaucracy synthesizes the different pieces of information and communicates this synthesis through proposed plans. The potential effects of these plans are relayed by private agents back to the bureaucracy for possible alterations. This interactive process continues until a consensus is reached. In short, deliberation councils provide a built-in feedback mechanism that helps the public and private sectors adjust to an ever-changing environment. They "can acquire more information than any one individual (member) for it has each member performing different experiments. Thus, the limitations on an individual industry's or firm's capacity are overcome."<sup>44</sup> Although deliberation councils cannot substitute for the informational attributes of markets, they certainly supplement them.<sup>45</sup>

Problems involving synchronization frequently arise in development.<sup>46</sup> They arise for instance in new industries with potentially large-scale economies. As Paul Milgrom and John Roberts have pointed out, "Economies of scale that are achieved in the manufacture of components of several products increase the need for coordination because the optimal scale of each product is an increasing function of the anticipated scale of the other products that use the same components."<sup>47</sup> From this perspective consider the following advantages of councils as coordination mechanisms: if a new airport is to be built, roads and trains to the airport must be ready by a target date. To induce a company to invest in creating the roads might require assurances that another firm has agreed to construct the airport. Similarly, hotelkeepers will invest once they are assured of the behavior of other relevant investors. Information demanded to achieve coordination required for a new airport may not be efficiently conveyed by the price system. Councils offer supplemental sources of information, providing decisionmakers with information about how parts of a large project fit together. They provide a forum

44. Lim (1981, p. 15).

45. In fact, councils work because they use markets as their guide. The plans developed jointly by the public and private sectors are tested against the realities in the marketplace.

46. See Gershenkron (1962).

47. Milgrom and Roberts (1991, p. 117).

to communicate strategy to all members of an industry. When a lack of synchronized behavior may be costly to several parties, the council can be especially helpful. For example, the price system does not take into account the true marginal cost of the early introduction of a product. Knowing the number of possible delivery dates requires communication not necessarily conveyed by prices. A council meeting can more easily reveal the marginal costs of a speedup for each supplier, making it possible to predict the cost of the final product. Inducing private sector actors to make one set of investments sometimes requires assurances that a related set will also be made. In those cases councils are helpful because they facilitate coordination.

Deliberation councils also help resolve externality problems (which in essence are also coordination problems). For example, an exporter who breaks into a foreign market bears all the costs, while results can easily be copied by firms that did not pay the initial costs of gaining entry. In the council, the costs of learning about new markets are distributed among council membership.<sup>48</sup>

A council might also help distribute burdens from future crises, thereby reducing the overall risk of a project.<sup>49</sup> For example, in Japan members of a council will shoulder the costs of a collective decision that causes a weaker member to go bankrupt. When downsizing is called for, the biggest firm in the industry may be asked to absorb smaller companies that take the loss.<sup>50</sup>

#### *Taming the Rent Seekers*

Whereas an absence of transparency has allowed governments of many developing nations to reserve economic opportunities for their clients, councils have permitted most of the HPAE regimes to avoid this pattern. In the council, information about the policy environment is shared among all players. Each has access to the same information, and information flows both ways. By contrast, in many developing countries, policy-relevant information is asymmetrically distributed. Private sector firms do not know what their competitors know and hence are uncertain about what their competitors will do; even announced government plans cannot be trusted. In essence, when the

48. World Bank (1993a).

49. In a discussion of risk sharing, credit markets, and participatory government intervention in Korea, Cho and Hellman (1993) make a similar argument.

50. Yamamura (1986).

parties have unequal information they will mistrust one another and will hesitate to cooperate on joint projects.

Mistrust creates a strong impetus toward rent seeking. In the absence of a credible and transparent policy regime governing market competition, pressure groups have incentives to lobby government officials. Lobbying can be viewed as a defensive measure that often occurs when each group assumes that others will lobby to acquire as large a share of the market either directly, for example, logging concessions, or indirectly, for example, import quotas. Hence, to protect its turf, each is induced to engage in as much lobbying as can be afforded. Seeking special deals or privileges thus becomes the *modus operandi* of groups. A council can eliminate this uncertainty and reduce mistrust by making policies transparent to all affected parties; by making information available to all, a council makes it more difficult for individuals or groups to obtain special favors from the government and for government officials to provide special treatment to individuals or groups.<sup>51</sup> Welfare losses attributable to directly unproductive profit-seeking (DUP) activities can thereby be reduced.

In many developing nations, patronage is the main source of rents and thus is central to the political support base of the regime. Informal political structures nourish the proliferation of patron-client ties. Impersonal institutions such as deliberation councils, by diffusing access to regime officials, can weaken patron-client ties and help the regime reduce the costs of rent seeking.

During the early stages of development, political and economic elites constitute small and overlapping circles. The closer an individual's ties to a regime, the more difficult it is for the regime to enforce rules that would alter that individual's behavior. Therefore, it is necessary to protect government ministries from individuals who wish to use connections to win exceptions, privileges, or modifications to rules. The advantage of policies approved by councils is that members will have to accept changes and adjust to rules that apply to all, since if they seek exceptions their lobbying will quickly become known to other members of the council. Through councils the government acquires greater capability to resist pressures from powerful individuals.

In sum, when rules, procedures, and regulations are discussed openly

51. Campos and Lien (1994) show that, if firms can reveal information without fear of being taken advantage of, the level of rent seeking falls, that is, firms have less incentive to engage in lobbying.

among the relevant parties and input from all parties is encouraged, a more transparent and impartial policy environment emerges. This constricts the possible avenues for seeking or granting special favors and raises the cost of and reduces the potential gains from rent seeking. Councils help limit the perverse effects of rent seeking: members effectively agree to the rules of the game that ultimately determine how rents are to be distributed among them. The rules could directly specify the distribution as in the case of industry downsizing in Japan or indirectly as in the case of export performance criteria in Korea.<sup>52</sup> In either case, rent shares are negotiated in a relatively open forum, making it difficult for individuals or special interest groups to seek special treatment and thus to derail good policies.

#### *An Implicit Constitution: Councils as Commitment Devices*

The use of deliberation councils to coordinate economic policy creates a structure of rights and expectations that induces investor confidence. In effect, a *de facto* constitutional framework to direct economic decisionmaking is erected. Violating the implied norms imposes costs on the government and on the private sector operators. To violate the procedural norms or etiquette that governs economic decisionmaking would require altering the rules governing the creation of policy.

Changing the rules imposes costs of its own. The party that forces those changes may ultimately wish for the protection they have abandoned. To avoid risks that disagreements over procedural changes may lead to unexpected outcomes, officials may decide to stay with the rules already in place. Moreover, an attempt to force a change in the rules without private sector participation would undermine the future value of the councils as a coordination and rent-sharing mechanism. That in turn would make policymaking more difficult.

Ultimately, the councils are commitment devices that restrain governmental discretion.<sup>53</sup> By granting authority to deliberation councils

52. Yamamura (1986); Lim (1981); Amsden (1989); Haggard (1990); Chang (1993). In Korea firm subsidies are based on their export performance and thus on the ability of firms to compete; in the former, the government, through the council, determines which firm(s) absorb the less profitable ones in the industry.

53. It is often argued that Korean business-government relations consist of the government's bribing, cajoling, or coercing private sector firms. See Amsden (1989); Haggard and others (1990); Lee (1992). But it should be emphasized that the government has applied the carrot and the stick impartially and consistently. If a firm fails to deliver, it

the government gains authority. As Daniel Okimoto puts it, "Without industry's willing cooperation, the Japanese state would not be nearly as powerful or effective."<sup>54</sup> An agreement from a deliberation council represents unanimity within an industry and increases the likelihood of legislative approval. In effect, the government relinquishes authority to gain the possible consent of the private sector to promote a government program. By granting authority to the councils, the government gains credibility that it can implement its programs. This in turn makes the government a more credible player nationally and internationally. An investor will choose a country where the government has the capability to protect the property rights of investors. The councils provide some of this capability because they imply that policies have the implicit consent of the relevant private sector actors.

Councils provide rules for gaining a consensus on economic policy. These rules are an implicit constitution offering guarantees against the imposition of policies detrimental to council members. Revisions of the rules or of policies are subject to the councils' purview, thus providing economic actors with assurances against sudden policy shifts. By imposing restrictions on its ability to alter policy, the state makes the property rights of council members more durable.<sup>55</sup> Economic entrepre-

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is penalized; if it delivers, it is rewarded. That is, the Korean state has refrained from the predatory behavior characteristic of many dictatorships.

Of course, the question then is how credible is the state's commitment to impartial and consistent implementation of the carrot and stick? Reputation is critical. If the state's goal is to promote growth, and it depends fundamentally on the help of the private sector (which was certainly true in Korea), then it must necessarily obtain the cooperation of the private sector by building a reputation for impartiality and consistency. By contrast, favoritism encourages DUP activities, which results in uncertainty about the "rules of the game." This restrains growth by making it difficult to obtain the needed cooperation. In short, the long-run cost to the state of ruining its reputation is a disincentive to playing favorites.

54. Okimoto (1989, p. 145). "Instead of labeling Japan a strong state, therefore perhaps it would be more accurate to call it a 'societal,' 'relational,' or 'network' state, one whose strength is derived from the convergence of public and private interests and the extensive network of ties binding the two sectors together."

55. Economic policy can be viewed as a contract between government and the private sector. Williamson (1985). However, contracts cannot address every possible contingency. To induce investments in fixed capital assets whose value is greatly reduced in alternative uses, that is, asset specific investments, the government must be able to commit to not expropriating those investments whether directly through confiscation or indirectly through arbitrary and frequent policy changes, that is, not renege on ex ante

neuralism is encouraged by the knowledge that today's policies will not create the profits for tomorrow's confiscations.

### *An Implication: From Import Substitution to Export-Oriented Industrialization*

Deliberation councils can be critical in facilitating the change toward export orientation from import substitution (ISI). By abandoning the relative comfort of the ISI regime, established firms open themselves up to the danger of losing market share by reducing their comparative advantage, for example, knowledge of the domestic market and control over distribution, and over other potential domestic competitors who may be much smaller. Deliberation councils can be harnessed to reduce this uncertainty and thus to provide better incentives for firms to support the export drive. Through these mediating institutions, information about developments in world markets is shared among all firms, giving each equal opportunities to respond. Subsidized credit can be directed to good performers to reduce the risk of breaking into world markets. In some cases, established firms and the government can agree to limit entry in the initial stages. In other words, these institutions help provide the necessary coordination needed to move from a low-level equilibrium to a higher-level equilibrium: because they guarantee the existing (and more often than not the major) players that none will be disfavored in the change of regimes (in the sense of fair application of the new rules and regulations), they induce the players to participate more willingly in the new programs; a larger pie and Pareto superior allocations result.

Public sources of credit are often necessary to promote an export drive. Private financiers have the means to test the waters in domestic markets but very rarely in foreign markets. Financiers are therefore reluctant to lend for exports and will consistently ration credit in favor of domestic production. Consequently, when domestic bankers combine with large, indigenous merchants, their preferred policy is a secure domestic market characterized by import substitution as opposed to exporting. But government-subsidized credit is not sufficient to guarantee good export performance. The carrot, that is, subsidized credit,

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agreements. But at the same time, the government must also have enough flexibility to change policy when external circumstances warrant. A council can serve as a "flexible" commitment mechanism.



without the stick, that is, penalties, may result in investment without accompanying export growth. Firms may take advantage of the credit but allocate it to nonexport activities.<sup>56</sup> Councils can be especially helpful in providing information that will help the government to direct credit to high-performing exporters.

### The Political Role of Councils

The East Asian experience reveals that access to information by all parties is essential for economic development. Information to make effective economic decisions is usually lacking in autocratic governments because the private sector has incentives to dissimulate and deny information to autocrats that can later use their knowledge to expropriate profits, to penalize dissent, and to provide privileges to insiders and allies. Information is usually used to maintain power, not to promote welfare-enhancing policies. As a result, autocrats typically lack information about private sector development, and the private sector usually has unreliable information about government programs and intentions. Thus autocracies have a problem of credibly committing to growth-enhancing policies. Dictators are unreliable partners in trade because of their above-the-law status.

In all the HPAs, the legislature is significantly weaker than the executive branch. Even in Japan, where the Diet plays a more active role in policymaking, until recently the ruling Liberal Democrat Party (through the prime minister) has generally dictated the thrust of policies. This top-down approach to policymaking has earned the HPAs the reputation as authoritarian states. Modifications to this conception are needed, especially if one considers that surveys of democracy typically correlate Asian governments with those of Africa as examples of autocratic rule.<sup>57</sup> Because the standard indexes of democracy are not

56. See, for example, the study of Boyce (1992) on the Philippines.

57. The Freedom House correlates the political systems of Korea, Malaysia, Singapore, Taiwan, and Thailand at the same antidemocratic extreme as a number of African regimes. The definition of political rights and civil liberties used in the rankings do not prioritize transparency of the regulatory environment, bureaucratic integrity, equal access to information by private sector operators, consultative instruments, security of property rights, freedom to contract, and the reliability of government commitments. The survey leaves out the factors contributing to private sector strength and government credibility. Thus results do not touch on the conditions that ultimately create a firm foundation for an independent civil society.

sensitive to the participation in policy by consultative bodies, they fail to reflect a fundamental difference between the polities of Asia and, for example, those of Africa. Consultative polities differ from autocratic regimes as much as they differ from representative regimes. Councils allow select groups in the private sector (based on function rather than on personal ties) to express their views on economic policies and have those views integrated into the final policy output. This feature gives councils credibility and legitimizes government economic policies; councils grant the private sector participants some influence over the rules that are to govern their sector and prevent those rules from being altered without consultation.<sup>58</sup>

### Summary

Japan, Korea, Malaysia, Singapore, Thailand, and Hong Kong have developed mechanisms for interaction between state and society, allowing the private sector to contribute effectively to the policymaking process. Consultative bodies induced private sector cooperation with the regime and helped to draw the elites into the process of market-led growth. Similar assurances of consistent private sector input into policy formation are rarely provided by autocratic governments. Nevertheless observers have all too often confused effective governance with the type of political regime and thus have failed to see the universal implications of East Asian experience. That experience suggests that the foundations of effective economic governance—commitment, coordination, and consultation—are likely to be independent of regime type. But it also suggests that consultative committees may fail to produce similar results in other developing countries unless a reputable economic bureaucracy exists to impose discipline among private sector members of a council.

As chapter 6 explores, each of these high performers created and nurtured a competent, relatively independent but accountable, economic bureaucracy. Unless the economic bureaucracy can deflect external pressures from regime insiders or powerful interest groups, agreements arrived at in a council could be easily undermined. To

58. It should be pointed out that in the early stages of English parliamentary government, representation was limited to a small privileged group, that is, those who could pay taxes to the king. See Root (1994). The councils are in a way functionally similar to England's ancient parliamentary system.

enable that bureaucracy to perform its role as arbiter, it must be able to resist such pressures. A weak arbiter cannot induce cooperation or compromise among rival groups; it cannot punish detractors nor reward performers. Similarly, a corrupt or incompetent arbiter cannot gain the confidence of participants. Therefore measures to prevent the arbiter's abuse of power must also be introduced.