

# **The East Asian Experience of Economic Development and Cooperation**

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# **The East Asian Experience of Economic Development and Cooperation**

Economic development in East Asia has followed a remarkable pattern, unlike any other developing regions in the world. In this paper, we would like to share this experience with the reader, discuss remaining issues, and contribute to the global development strategy debate.

## **Performance of East Asia**

During the last half century, the economic performance of the developing world has been far from uniform. Developing countries were polarized into those that made great progress in catching up and those that were mired in stagnation. The majority of the East Asian countries belong to the first group<sup>1</sup>.

The following phenomena have been commonly observed in East Asia. Some of these features are unique to this region.

- Diversity in ecosystem, population, ethnicity, religion, social structure, and political regime.
- Equally great diversity in GDP, per capita income, and economic development.
- High growth sustained over a long period almost throughout the region.
- Associated with this high growth are high savings and investment rates, active but managed external opening, export orientation, industrialization, and general improvements in social indicators.

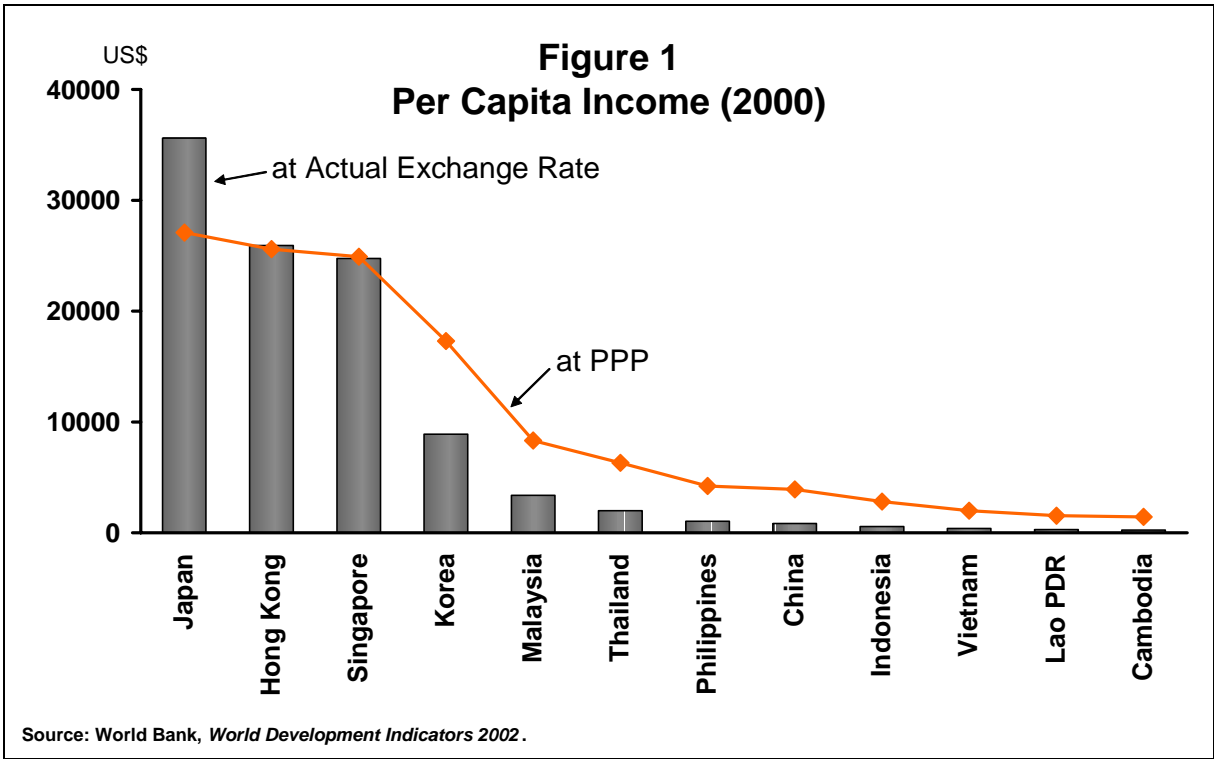
However, the path trodden by East Asia has not always been smooth. Some countries failed to achieve high growth, and the region was hit by occasional setbacks. East Asia has had its share of hardships in its history, with hot and cold wars, social instabilities and economic crises.

Currently, East Asia faces not only the old problems of poverty and political strife but also the new challenges posed by economic growth such as emerging income gaps, environmental degradation, urbanization and congestion, and various social evils. Furthermore, the countries in the region are under pressure to enhance

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<sup>1</sup> We define East Asia functionally, as those economies that are already taking part in *Asian dynamism*, or the regional production network linked by trade and investment, as discussed below. This includes Japan, China (including Hong Kong), Taiwan, Korea (ROK), Singapore, Malaysia, Thailand, Philippines, Indonesia, and Vietnam. Some countries such as Laos, Cambodia, and Myanmar are preparing to join this regional network.

domestic capabilities in order to avoid crises associated with globalization and to sustain growth into the next stages of development.



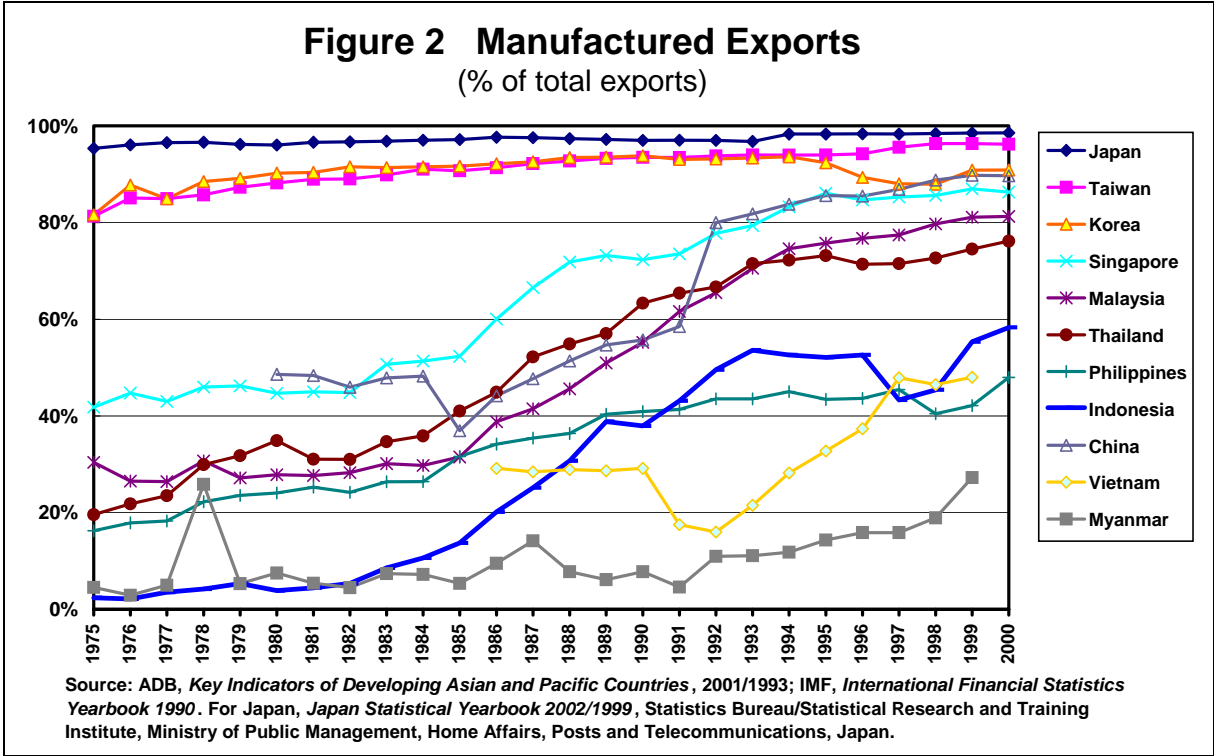
**Growth Driven by Trade and Investment**

For each country in East Asia, the long-term growth path and the achievement of industrialization can be tracked by income trends and structural shifts in GDP and exports. However, the unique feature of East Asian growth is that it has been attained through the very existence of East Asia as a powerful arena of economic interaction among its members, and not merely by “market-friendly” policies or good governance of individual countries alone<sup>2</sup>.

One by one, countries in different development stages realized economic growth by participating in the dynamic production network created by private firms. Linked by trade and investment, a system of international division of labor with clear order and structure exists in the region. Under this system,

<sup>2</sup> The World Bank’s *Miracle* report cited macroeconomic stability, human resource development, export orientation, and benign government-business relationship as the causes of high performance in East Asia [World Bank 1993]. Later, in the aftermath of the Asian financial crisis, the Bank warned that growth would not return to East Asia unless institutions and policies are improved in each country [World Bank 2000]. However, evaluation of policies of individual countries is not enough to understand the sources of dynamism in this region. The future of East Asia critically depends on the sustained vitality of the region as well.

industrialization has proceeded through geographic widening on the one hand and structural deepening within each country on the other. Terms like the *flying geese pattern*, *structural transformation chain*, and *Asian dynamism* refer to these supply-side developments. To understand this mechanism, we must go beyond individual countries to analyze the production structure, intra-regional trade, and investment flows of East Asia as a whole.

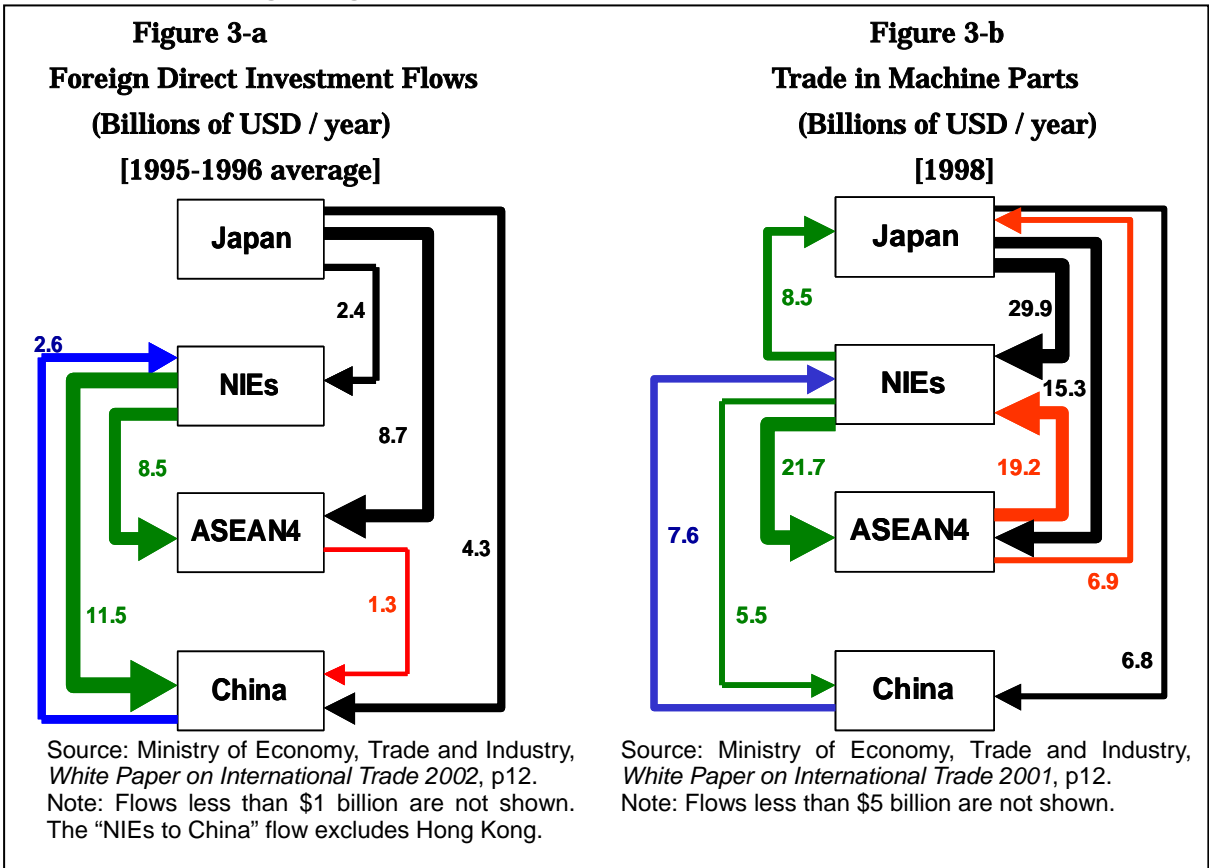


For developing countries in East Asia, economic development was tantamount to becoming one crucial link in this production network under competitive pressure from and cooperative relations with neighboring countries and, through it, upgrading their industrial capabilities from low-tech to high-tech. To initiate development, they had no choice but to undertake international integration via trade and investment. However, the integration strategies of latecomers like the ASEAN4 and latest comers like Vietnam are different from those of the early developers such as Japan, Taiwan and Korea.

East Asia as a region has offered a political, economic and social model and an enabling environment for the catching up of latecomer countries. Every country was under strong market pressure from above and below to constantly improve capabilities and climb the ladders of development. What drove them were national desire for material well-being and the demonstration of excellence from neighboring countries, not conditionalities or policy matrices introduced by international organizations. No other developing region has formed such an organic and dynamic interdependence as East Asia.

For the Japanese economy, East Asia is the most important developing region. For East Asia, too, Japan is a particularly important country as the largest donor and the principal partner in trade and investment. Moreover, Japanese corporations are the chief architects of the East Asian production network. Asian dynamism has also been supported by the trade and investment relationship with the EU and the US, as well as the extensive business network of Taiwan, Hong Kong, and the overseas Chinese.

As the dominant ODA provider in East Asia, Japan has mobilized its extensive tools for economic cooperation mainly to spur and complement the market-based economic linkage. The majority of Japan's ODA projects placed high priority on assisting the self-help efforts of the East Asian developing countries to attain a suitable status in the region's production network and, through it, catch up with the forerunners and overcome social problems. Japan's ODA in infrastructure, human resource development, technical assistance and intellectual support for policy formulation and institution building has greatly contributed to reinforcing Asian dynamism by removing obstacles and generating new trade and investment flows. In fact, Japanese ODA projects have often been formulated in response to the needs of the private sector in Japan or the East Asian developing countries. The resulting economic prosperity and social stability in East Asia have in turn brought significant benefits to Japan.



## The Roles of Government

To actively respond to the challenges from the regional and global networks as described above, the developing countries in East Asia must undergo a great transformation. While the main players of economic development are undoubtedly private firms, simply deregulating and opening up the private sector does not generate sufficient impetus for growth if the country is saddled with underdeveloped markets, lack of human resources and technology, and low productivity. In order to kick start an economy trapped in the vicious circle of low income, low savings, and low technology, the role of government is crucial as an external agent imparting order and direction to the national economy.

The role of government envisaged by the World Bank has shifted dramatically, from the unwarranted optimism in the early postwar period to the advocacy of small government in the 1980s, the call for institution building in the 1990s, and the more balanced view at present. But we must remember that the discipline and activism of the East Asian governments were stipulated by their development stages and the region's needs. If the government fails to take certain required actions, the country will remain stagnant as it cannot join the regional production network. In the reality of East Asia, it is all too clear that isolation leads to economic backwardness and that inability to cope with the problems generated by growth destabilizes the society. The unproductiveness of *laissez-faire*, as well as rigid control, is proven not theoretically but by the actual examples of neighboring countries.

*Good governance* must also be redefined in the East Asian context. The usual components of good governance, such as macroeconomic stability, structural reform, administrative efficiency and transparency, social participation and the like, do not necessarily coincide with the conditions needed for growth driven by trade and investment. Among these, macroeconomic stability is certainly a must. But for the other components, East Asia has achieved high growth without them. It is probable that different and more sharply defined components of good governance are required to initiate growth under international integration.

The most basic task of the East Asian governments is to establish a stable political regime and social unity which are the preconditions of economic development. For this purpose, most countries in East Asia have chosen *authoritarian developmentalism* [Watanabe 1995], or authoritarianism with

capability<sup>3</sup>. This regime, which is quite different from simple dictatorship, features (i) economic nationalism in pursuit of material prosperity; (ii) obsession with external competitiveness under industrialization and export orientation; and (iii) top-down decision making under a powerful and economically literate leader and a supporting elite group. Such a regime often emerged after a military coup and under a severe threat to national security from within or without. Its management is not necessarily “democratic” by Western standards. Evaluation of this regime varies. However, it is clear that the adoption of this regime was motivated by the external and temporary need to initiate growth in the regional environment. Since its value is historically conditioned, the very success of economic development will in time deprive its legitimacy, forcing its exit and an introduction of a more democratic regime. Such transition has already occurred in the forerunner societies, including Korea and Taiwan.

Once social stability and policy consistency are attained as basic conditions, the East Asian governments have three important roles to play.

First, *the government must create a market economy*. In the poorest or transition countries, domestic markets are extremely primitive. In terms of productivity, organization and human resources, such countries have not reached a stage where mere deregulation can unleash the latent market power to sound development [Ishikawa 1990]. Each country must constantly and flexibly mix market and government according to its development stage. Naturally, this mixing must be done by the government. To create a market economy, rules and frameworks such as laws, deregulation, privatization and free trade are important but not enough. The government must also pay attention to and take action on the real sector concerns, such as trade, investment, technology and industrial structure. Competitiveness must be given pragmatic support and concrete contents.

Second, *the government must actively promote international integration while managing its risks*. In East Asia, as noted above, economic development and external integration are two sides of the same coin and must proceed in tandem. Of these, integration is the primary action since it initiates growth by internalizing Asian dynamism. The timing, sequencing and scope of opening up is extremely important. Developing countries must design an integration timetable which gives sufficient incentive for enterprise efforts while avoiding economic

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<sup>3</sup> The exceptions include Hong Kong which remained a free economy and the Philippines under President Ferdinand Marcos which was a different type of authoritarianism without developmentalism.

crisis and social instability. Here again, a delicate balance between liberalization and protection is required, which cannot be guided by the general theory alone.

Third, *the government must mitigate the negative aspects of growth*. In addition to the long-standing problems of poverty and income gaps, economic growth creates a set of new problems. Foremost among them are emerging income gaps among individuals, ethnic groups and regions. Environmental pollution, issues associated with urbanization such as rural-urban migration, traffic congestion and housing shortages, and social evils such as crime, corruption, drugs and prostitution, tend to arise. Economic growth is sustainable only when the opportunities and fruits of growth are perceived to be shared equitably by the standards of that society. When that is secured, the virtuous circle of economic growth and social stability can begin.

We cannot say that the governments of the high-performing East Asian countries fulfilled these three roles perfectly. But at least they did not make a fatal error in any of these areas that could put them off the track of economic development.

Many factors have been cited to explain East Asian growth, including the high levels of education and motivation, good government-business relationship, export promotion, income equality, and so on. But these should be regarded as the concrete achievements by individual governments for the purpose of executing these roles well, not the causes of success. It is important to understand the totality of historical and regional environment of East Asia and the basic problems of development that it poses. Evaluation of individual policies in isolation or an attempt to directly transplant them on different soils is not very useful.

### **The Roles of Regional Cooperation**

The maintenance of Asian dynamism requires regional cooperation in addition to policy efforts by individual countries. Free markets do not always guarantee the healthy development of private trade, investment and production. Problems and crises which are beyond private solutions will occur. Regional cooperation to avoid or remove difficulties, support industries from the sidelines, and present visions to reduce uncertainties have greatly contributed to East Asian development, and will certainly continue to do so in the future. This can be construed as the supplying of broadly defined international public goods.

Up to now, economic cooperation in East Asia has emphasized human resource



development, building infrastructure, promoting small and medium enterprises and “supporting industries,” creating various institutions for industrialization, coping with negative aspects of growth, and intellectual aid on policy formulation. These overlap with the priority areas of assistance by Japan, the top donor in East Asia. Regional cooperation in East Asia has been characterized by *open regionalism* in the sense that it did not discriminate against countries outside the region. Cooperation has been promoted through voluntary action and peer pressure, not by forced conditionalities or uniform deadlines.

Economic integration in East Asia has been market-driven, with private activities as primary and public policies as supplementary. This is very different from institution-driven integration such as the EU, NAFTA and MERCOSUR. In this sense, East Asia has already achieved the private linkages that other integration schemes aim to create. Recently, however, new efforts in institution-driven integration are being initiated to further accelerate or complement the market-driven integration in East Asia. The Japanese government also shifted its external policies from nondiscriminatory multilateralism to institution-driven regionalism a few years ago [METI 2001, Urata 2002].

At present, the most important framework in East Asia is *ASEAN plus Three* (ASEAN+3)<sup>4</sup>. Other regional schemes, such as the ASEAN Free Trade Area (AFTA), the Chiang Mai Initiative for central bank cooperation, the ASEAN Regional Forum (ARF), the Asia-Europe Meeting (ASEM) are related to ASEAN+3. Additionally, bilateral free trade agreements (FTAs) between Japan-Singapore, Japan-Korea, and so on are being concluded or negotiated. Regional FTAs are also proposed between Japan-ASEAN and China-ASEAN.

In the future, the following topics are expected to be crucial for regional cooperation (many of them are continued problems from the past):

- Regional peace and security as the precondition of prosperity
- Narrowing the gap in income and development stages between the earlycomers and the latecomers
- Promotion of globalization together with the reduction of its negative influences (economic crises, emerging income gaps, and so on)
- Human resource development, institution building, and improving governance in order to sustain growth

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<sup>4</sup> The members of the Association of South-East Asian Nations (ASEAN) include Singapore, Malaysia, Thailand, Philippines, Indonesia, Brunei, Vietnam, Cambodia, Laos, and Myanmar. ASEAN+3 consists of these countries plus Japan, China, and Korea.

East Asian regionalism can also serve as a vehicle for transmitting the East Asian vision to the rest of the world. Although East Asia is extremely diverse, something close to consensus occasionally emerges which is different from the views of the Western countries or international organizations. For instance, many East Asian countries are uncomfortable with the idea of unrestrained markets, the IMF's response to the Asian financial crisis, and the World Bank's development framework where poverty reduction is the only goal. Institutionalized East Asia can be the framework for translating such uneasiness into constructive proposals, to be projected to the rest of the world and influence the policies of the international organizations.

In the age of globalization which began to accelerate in the 1990s, the policy tools for Asian dynamism must be amended to reflect the new reality. Several decades ago when Japan—and later, Taiwan and Korea—were rapidly industrializing, *infant industry protection* was adopted, in which local enterprises were strengthened under temporary protection. However, this policy is no longer feasible because (i) early trade liberalization is required for all countries; and (ii) local firms in the remaining developing countries lack capability. But full and immediate liberalization and external opening will not lead to the catching up of these latecomers. We need to come up with practical policy advice as to how industrialization of these countries should be supported by public policies as well as regional cooperation in the age of globalization. East Asia is an ideal place to initiate this intellectual quest.

### **Economic Development and Poverty Reduction**

Since 1999, the World Bank has promoted cutting poverty as the ultimate goal of development and required all poor countries to draft a *poverty reduction strategy paper* (PRSP) as its principal tool. The United Nations Millennium Summit in September 2000 adopted the *Millennium Development Goals* (MDGs), a set of numerical social goals to be achieved by 2015. At present, poverty reduction dominates the global development debate.

In East Asia, no country has adopted poverty reduction as the only goal in national economic development. A more balanced approach is favored, where economic growth is pursued strongly while serious concern for social equity is also emphasized. It may be argued that this approach, rather than concentrating on the narrowly defined poverty reduction, produced more remarkable results in social development over the long run (though we do not deny that problems did arise in environment, congestion, income gaps and so on, and many East Asian

governments were slow to act on them). It is generally agreed that there is no ultimate solution to social problems (including poverty) without sustained economic growth. This fact is also well understood in East Asia.

The United Nations' MDGs and the World Bank's PRSP, if applied uniformly, will be inconsistent with the development strategies in East Asia. Strain is already visible in the PRSP of Vietnam, the first country to embrace this approach in East Asia<sup>5</sup>. For those developing countries in East Asia which possess clear national development visions and are striving to implement concrete policies to realize them, economic cooperation should be provided to supplement and strengthen the nationally owned policy framework, rather than bringing in an entirely new program.

More generally, application of PRSP must be flexible enough to reflect the different conditions of each poor country. For some countries, including Vietnam, we can even ask whether PRSP is needed at all. The criteria for localizing PRSP should include (i) the degree of dependency on aid and debt reduction, (ii) the existence and quality of a national development plan (including whether it effectively guides the budget and public investment); and (iii) causes of poverty. According to these criteria, PRSP should be diversified flexibly and pragmatically.

### **Implications for Countries outside East Asia**

Most people interested in East Asia are tempted to ask the question: are these lessons transferable to other regions, including Sub Saharan Africa? The answer to this question must take a somewhat complex form, instead of a simple Yes-or-No. Since situations in each country and region are different, it is easy to understand that direct replication of the East Asian model is unlikely to succeed. In our opinion, the East Asian development experience and the Japanese experience of economic cooperation in the region can offer the following suggestions for countries outside East Asia.

In the current development strategy featuring MDGs and PRSP, the close relationship between economic growth and poverty reduction is widely recognized *as a general principle*. At the operational level, however, budgeting and aid

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<sup>5</sup> For details, see GRIPS Development Forum's *information module*, "Diversifying PRSP: The Vietnamese Model for Growth-Oriented Poverty Reduction." In the drafting process of Vietnam's PRSP, a friction arose between the Vietnamese government who considered this document subordinate to the existing national development plans and some donors who tried to elevate the PRSP to the central instrument for budgeting and policy making. In the completed PRSP, this issue was left ambiguous. The World Bank highly evaluated the strong ownership of the Vietnamese government and lauded this PRSP as "best practice."

modality discussions over pro-poor policies are quite active, while the formulation and implementation of growth strategies which are concrete, feasible and specific to individual poor countries have hardly begun. This imbalance should be corrected by strengthening the support for concretizing the growth strategy for each poor country.

To realize growth through trade and investment, the criteria for *good governance* must be redefined, as noted earlier. Similarly for donor countries, the *selectivity* criteria for allocating aid resources across different developing countries need to be revised as we shift the purpose of economic cooperation from improving health, education and environment to initiating growth under international integration. For growth, political stability and social integration are absolutely necessary. Beyond that, we need a strongly committed and economically literate leadership, a technocrat group to support it, an administrative mechanism to execute economic policies consistently, and popular support for growth-oriented development strategy.

*At the level of individual policies*, experiences are not transferable from East Asia to Sub Saharan Africa, since these regions differ in degrees of social stability, human resources and knowledge, and regional economic dynamism. However, the *methodology* of industrial research and policy formulation should be transferable<sup>6</sup>. Japanese economic cooperation is characterized by the totality of vision, long-term orientation, and real sector concerns. Respecting the uniqueness of each developing country, Japanese experts are interested in supporting the real sector efforts, including industrialization, trade promotion, and improving skills and technology, by combining different aid tools and from a total and long-term perspective. They want to work with the developing countries as lasting partners in good times as well as bad. This approach can complement short-term contract orientation, frequent performance reviews, and globally common frameworks favored by the international organizations. It can supply patience and the respect for individuality which are desperately lacking in the current global development strategy. The ultimate goal of Japanese economic cooperation is to help discover—and implement—the most suitable growth strategy for that particular developing country, irrespective of whether it has an East Asian origin or not. This idea can be applied to Sub Saharan Africa or any other region. We believe that one-time help and partial advice are of little use.

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<sup>6</sup> The Japan International Cooperation Agency implemented a large-scale and comprehensive policy support program to Vietnam from 1995 to 2001. This program analyzed and advised on macroeconomic balance, fiscal and monetary policies, agriculture and rural development, trade and industrial policy, state-owned enterprise reform, promotion of small and medium enterprises, and response to the Asian crisis. Similar programs have been implemented in Mongolia, Laos, and Myanmar.

However, much preparation will be required if Japan decides to commit itself to such long-term assistance in Sub Saharan Africa, where it has had little intellectual engagement in the past. Domestic consensus for channeling aid to regions other than East Asia must also be formed. This is a challenging learning process for Japan. If such aid is to be extended to other regions, Japan should first select a very small number of target countries with highest potential for growth by the revised criteria for selectivity as discussed above. Strong national ownership of the growth policy is a particularly important condition for selection. Aid resources should be concentrated on these few countries rather than diffused widely and thinly. A permanent policy research team should be established in each selected country to engage in (i) constant policy dialogue with the authorities; (ii) partnership with international organizations, other donors and NGOs; and (iii) policy inputs to Tokyo. Only after such a system is installed, Japan can start to offer development assistance to other regions that is truly characteristic of Japan, as described above.

Since other developing regions lack a regional production network as found in East Asia, growth policies in the context of such regional dynamism must be adjusted accordingly. We firmly believe that a single developing country without regional advantages can also activate growth through trade and investment. For example, strategies for primary commodity processing or light industries can be designed and supported comprehensively, including marketing, distribution, organization, training, technology, and finance. Concrete entry points will differ from country to country, and thus cannot be generally stated. Such assistance must be provided not only bilaterally by Japan, but through multilateral channels in cooperation with international organizations and other donors.

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