

Overview

Transformation Strategy and the Critical Role of National Leaders and Economic Technocrats



Policy Formulation in Developing Countries

About This Course

- ❑ How development policies are designed and implemented (**HOW** rather than **WHAT**).
- ❑ Methodology: comparison of international best, worst and other practice cases (not mathematical modeling or cross-country regressions).
- ❑ We will look at both *positive* and *normative* aspects (how things are and how things should be).
- ❑ There is no one-size-fits-all answer. We will deepen our knowledge without necessarily arriving at one conclusion.
- ❑ Interactive and open-ended discussion, with student presentations toward the end.

Today's Topics:

Background Ideas for Policy Formulation

- ❑ Politics and economics
- ❑ Key relationships that determine policy effectiveness
- ❑ Institutional dynamics
- ❑ Middle income traps
- ❑ Policy learning
- ❑ Critical importance of national leaders and economic technocrats
- ❑ Examples from Japan, Taiwan and Korea

Creation of a Developmental State

Predatory/patrimonial state—power and state machinery for perpetuating personal benefits of leader, his family and supporters

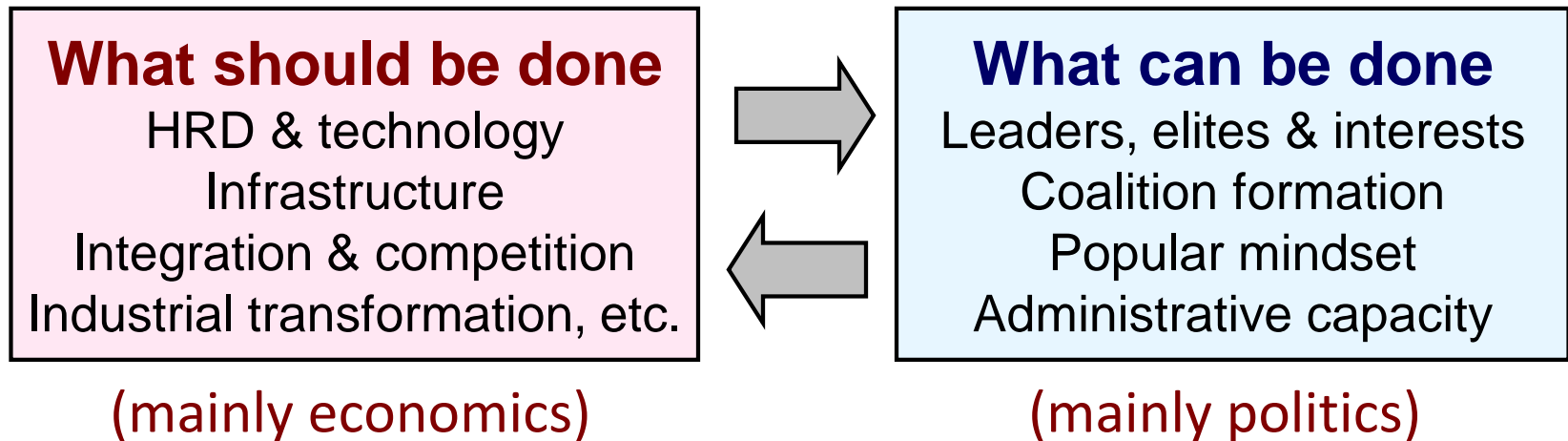
Developmental state—policies and institutions for value creation and competitiveness for all people and enterprises

How can we promote DS instead of PS?

- ❑ Political approach—encourage/fight for the emergence of developmental leaders and agenda
- ❑ Donors' approach—support leaders and groups that are developmental and action-oriented
- ❑ Academic approach—show concrete and feasible growth models for willing governments to learn and adopt

Policy: Desirability vs. Feasibility

Development is both a political process and an economic process.



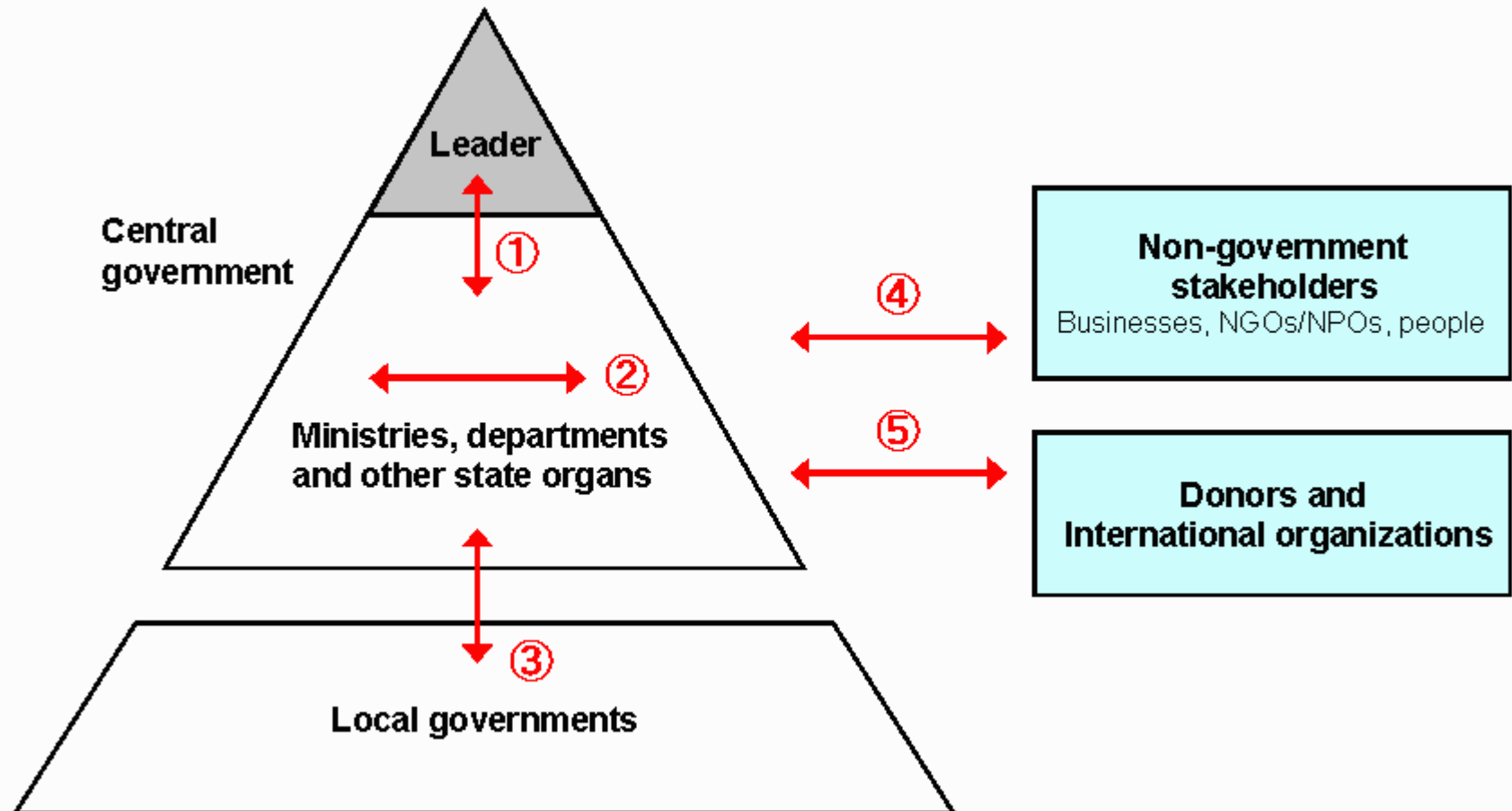
- ❑ Each country is unique in *what needs to be done* (economics) as well as *what can actually be done* (politics & administrative capacity).
- ❑ Any policy maker must work with economic and political space simultaneously.

Key Factors and Relations

- 1. Leadership style**
- 2. Horizontal coordination within central government**
- 3. Vertical coordination between central and local governments**
- 4. Relation with non-government stakeholders**
- 5. Relation with foreign players**

- ❑ We look at these five factors/relations which are critical in determining policy effectiveness.
- ❑ We do not pre-impose one ideal form (“international best practice”) on each relation. Answers may be many. Each country must devise its own model based on local reality.

Key Relations Illustrated



Institutional Dynamics

After understanding the current status and setting the desired goal, how can we move from the one to the other?

Common obstacles

- Political resistance: corruption, vested interests, neo-patrimonialism, predatory state
- Incompetence: leaders, advisors and officials do not know or care
- Lack of knowledge or a mistake in designing transition steps
- Bureaucratic sectionalism: no ministry or department has full authority or responsibility to execute reform; inertia or rivalry prevails

Comparative Institutional Analysis



Aoki Masahiko
1938-2015

- ❑ Prof. Aoki and other researchers at Stanford University and Tokyo University initiated CIA.
- ❑ It is based on evolutionary game theory.
- ❑ Some questions
 - ✓ Why do multiple systems emerge and coexist, without any system dominating all others?
 - ✓ What is the dynamic mechanism of moving from one system to another?

Key Concepts of CIA

Institutional complementarity

Many institutional elements are complementary and reinforce each other (e.g., OJT, life-time employment, keiretsu system, main banks, management-labor cooperation, etc. in Postwar Japan).

Strategic complementarity

Individuals adopt strategies that fit particular social rules (e.g., people in competitive society study professional skills; people in connection society give parties & gifts).

Path dependence

Any system, once started, will persist unless enormous effort or shock impacts it (e.g., continuation of the US system, Japanese system, Chinese system, etc. with only minor changes).

Forces of Systemic Change

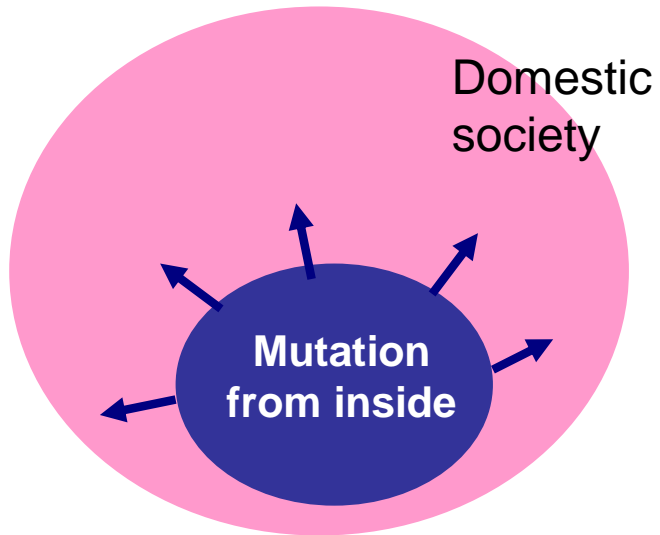
How can a solidified social system change?

- ❑ Collective mutation
- ❑ Foreign pressure (contact with another system)
- ❑ Policy as *deus ex machina*
 - Strong leader
 - Political parties, interest groups, people's movement
 - Researchers, advisors, intellectuals

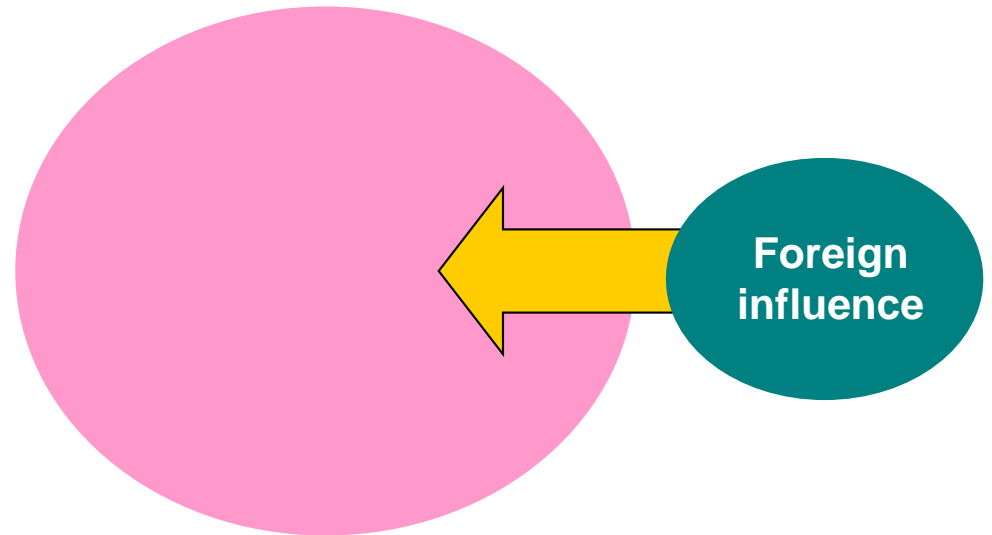
Those who are inside the country but do not follow the rules of the existing system initiate change against resistance

- ❑ Combining policy and foreign pressure

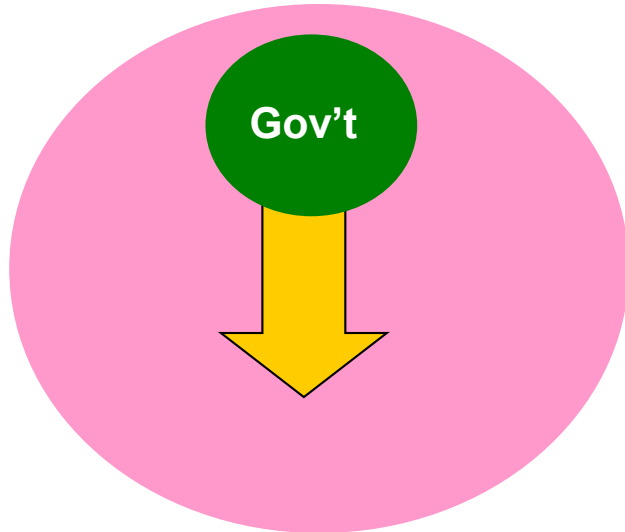
Collective mutation



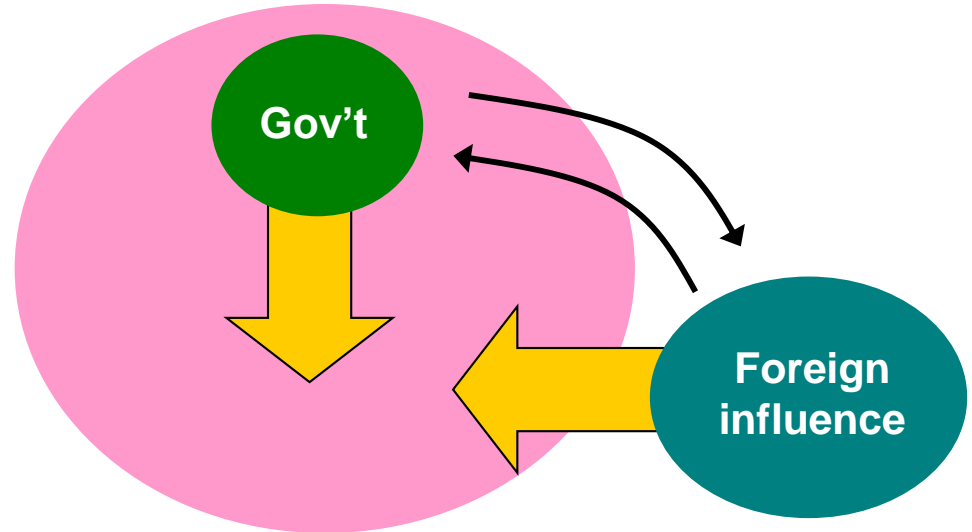
Foreign pressure



Policy



Policy and foreign pressure



Nations are Not Equal and Policy Quality Matters

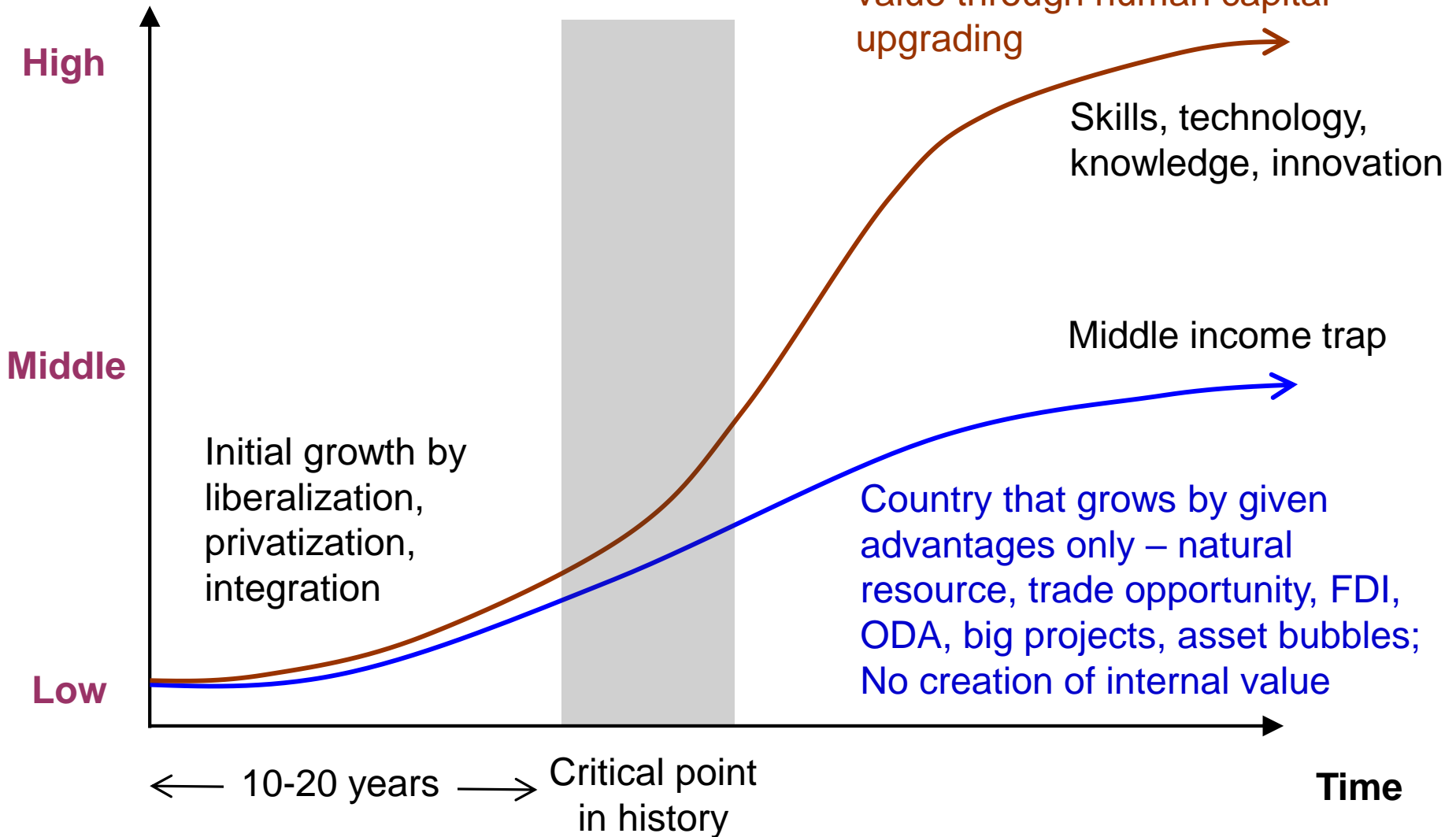
- ❑ Development performance differs greatly across nations. Some nations quickly reach high income while others slow down or stagnate at low or middle income.
- ❑ Diverse performance reflects difference in **private dynamism** and **policy quality** —not amounts of aid, trade, FDI, natural resources, etc.

**Economic performance = Private dynamism + Policy quality
+ External factors**

- ❑ In the long run, private dynamism dominates. Policy is important in enhancing private dynamism and managing external negative shocks.
- ❑ My working hypothesis: **the lack of policy quality is the main cause of poverty traps, middle income traps, or any other long-term growth problem.**

Why Do Nations Diverge?

Per capita income



Middle Income Traps

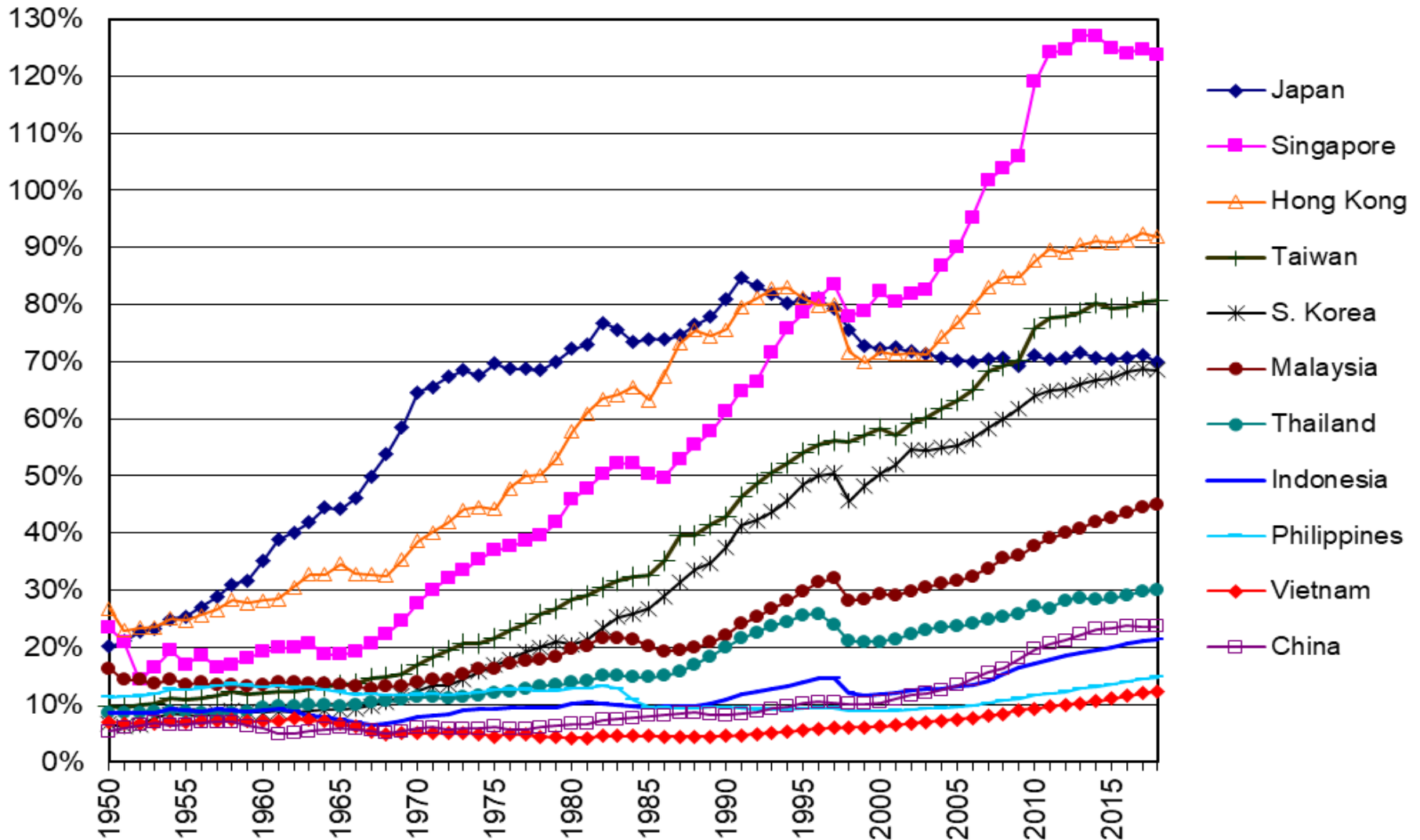
A Structural Definition

- ❑ A middle income trap is the situation where an economy is stuck at income dictated by **given resources** and **initial advantages** and cannot rise beyond that level -- *growth is given, not created.*
- ❑ Countries may reach middle income by liberalization, privatization and integration, but reaching high income requires strong policy effort to promote private dynamism, not laissez-faire.
- ❑ Growth based on FDI, aid, big projects, natural resources, or locational advantages will eventually end. The true source of development is value creation by domestic citizens and enterprises.

Speed of Catching Up: East Asia

Per capita real income relative to US

(Based on Real GDP per capita in 2011USD)



Source: Maddison Project Database, accessed on April 8, 2021.


The Phase Shift

From Light Manufacturing to High-tech Industries

Light manufacturing

- In the early stage, labor-intensive low-technology sectors such as garment, footwear, food processing, electronic assembly (PCs, phones) dominate.
- Domestic value creation is low. A large amount of unskilled (female) labor is needed. Few engineers and technicians are required.

Liberalization, privatization and integration are generally sufficient



Japan underwent this transition around the 1920s, and Korea and Taiwan in the 1970s. However, many developing countries are unable to cross this threshold (middle income trap).

Technology-based industries

- Establishment of high-tech, value-creating sectors such as metal, machinery, chemicals, IT and high-tech services requires technology learning and retention of highly skilled engineers.
- Policy must assist technology acquisition, investment, finance, etc. Due to scale merit, large monopoly tends to emerge.

Effective policy intervention to upgrade private capacity is essential

Possible Causes of Middle Income Traps

❑ **Economic shortcomings (primary)**

The private sector is unable to produce globally competitive firms and industries (even with official support).

❑ **Worsening social problems**

Government fails to ameliorate growth-related problems such as income/wealth gaps, regional/ethnic inequality, environmental destruction, congestion, materialism, etc.

❑ **Non-developmental political regime**

National leaders are interested in preserving their power and benefits and do not promote (or even suppress) emerging firms and industries.

Learning from International Experiences

- ❑ To improve policy, a comparative perspective is crucial across countries, across time, and across sectors and firms.
- ❑ Learn **mindset** and **methodology** for conducting industrial strategies effectively. Learn *how to make policies*.
- ❑ Early achievers (Japan, Korea, Singapore, etc.) learned policies through self-effort and trial-and-error. For today's latecomers, more systematic learning is possible and perhaps needed.
- ❑ The key is to acquire capability to create policy packages suitable for each country and situation using foreign models as building blocks.

Don't Copy-and-Paste Foreign Models

- ❑ In any international comparison, **globally common features** and **country-specific uniqueness** are always present. Clearly distinguish them when deciding exactly what to import from abroad.
- ❑ It is necessary to (i) select the right benchmark countries and periods; and (ii) properly adjust foreign models to suit your local context (“**translative adaptation**”).
- ❑ Two attitudes that fail:
 - (i) Refusal to learn from others (“we are very unique, and other countries cannot be our model.”)
 - (ii) The copy-and-paste approach (a good model should be adopted regardless of the conditions of the home country).

Confucius (551-479BC): 「子曰学而不思则罔思而不学则殆」 “Learning without thinking is useless; thinking without learning is precarious.”

Learning = knowledge collection

Thinking = creation of your model by selection and adjustment

Not WHAT but HOW

- ❑ Industrial policy contents are similar across countries and usually include:
 - Education and training, export promotion, import substitution, incentives for targeted sectors and activities, SME support, FDI attraction, linkage creation, power and logistics, industrial parks/clusters/corridors, R&D, technology transfer, low-interest policy loans, ICT, startups, innovation, standards, worker rights, green manufacturing, regional planning, etc.
- ❑ It is not **WHAT** governments plan to do but **HOW** competently they execute these common policies that matters.
- ❑ It is **HUMANS**, not resources, laws, institutions, technology or machines, that are the ultimate source of development.

Critical Importance of Leadership and Technocrats

A national leader who is wise, strong, action-oriented and respects democratic rules is crucial.

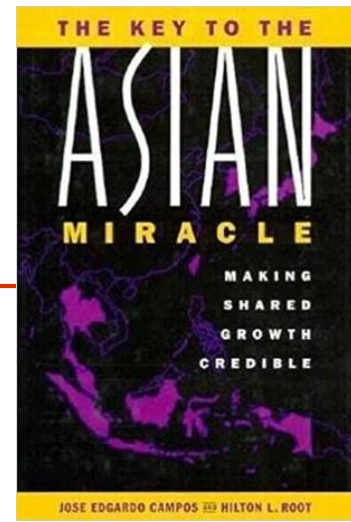
Capable and dedicated technocrats must support this leader.

➔ **Both are needed for successful development.**

- ❑ Between them, leadership is primary because a good leader can create competent technocrats if they don't yet exist (Taiwan 1950s, Korea 1960s).
- ❑ When both are installed, a nation can prepare other ingredients of economic growth (visions, goals, roadmaps, targeted sectors, action plans, policy organization, public-private dialogue, etc.)
- ❑ **The problem is that no one knows how to foster and install good national leaders (inspiring stories, comparative studies, elite schools, donor support...?)**

Creation of Competent and Clean Technocrats

Ed Campos —World Bank's East Asian Miracle Report 1993 (Chapter 4); The Key to the Asian Miracle 1996 (co-author)



East Asia's high performing economies attained shared growth because their governments deliberately created three necessary conditions.

1. **An inclusive mechanism** to let all citizens participate in growth (education, land reform, rural development, strong SMEs, etc.)
2. **Productive government-business relationship** based on shared information, mutual respect and joint decision making.
3. **Competent economic technocrats** who pursue welfare for all rather than self interest.

Countries that seriously make these institutional efforts can achieve shared growth (institutions can be created, not given).

Japan: Ministry of International Trade and Industry (MITI) in the 1960s



GRIPS lecture by Masatake Wada, former MITI official during 1966-96 (Feb. 2021)

1. **Broad perspective and capacity** — MITI's mandate was wide: industry, trade, energy, mining, SMEs, investment, technology, intellectual property, etc. Its functions were also broad: vision-setting, research, consensus-building, law-drafting, implementation, monitoring, etc.
2. **Clean and good relationship with politics** — MITI submitted policy proposals to politicians who deliberated on them. MITI acted as a professional body independent of politics.
3. **Thick information network with private sector** — MITI and businesses shared the same awareness and future visions. Industrial policy was a joint work between MITI and businesses.

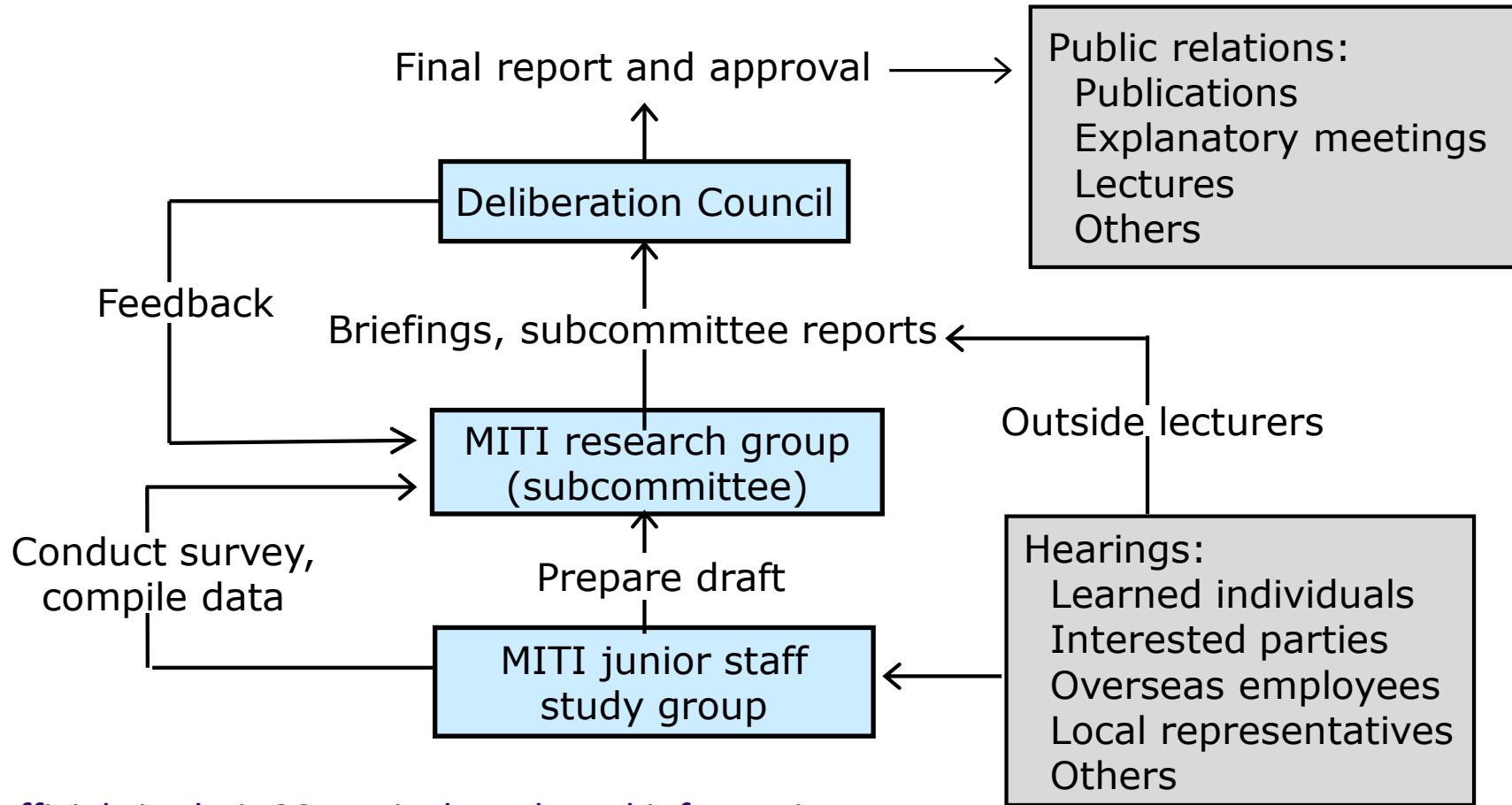
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- 4. Internal structure** — MITI was composed of vertical and horizontal bureaus. The former dealt with sectoral issues and the latter managed cross-cutting issues. MITI staff rotated every 2-3 years to experience many positions.
- 5. Strong motivation of MITI staff** — despite low salary, MITI staff were very proud to work on industrialization, a big national dream. They were very concerned about Japan's future, and organized private study meetings inviting academic and business people after working hours (without overtime pay).

Former MITI building



MITI's Policy Making Was Bottom-up



Young officials in their 30s actively gathered information and interacted with stakeholders, thus having substantive influence on final result—unlike in most other countries where young officials only take orders from above and do what was assigned.

Source: Ono (1992); original graph was rearranged so reporting direction goes from bottom to up.

Taiwan: Ministry of Economic Affairs (MoEA)



- ❑ Up to the 1980s, a powerful bureaucracy—Industrial Development Bureau of the Ministry of Economic Affairs (IDB/MoEA)—and a handful of elite figures shaped industrial policy (Robert Wade, *Governing the Market*, 1990).
- ❑ Key policy instruments included SME finance, market regulation, trade promotion agency, credit facilities and insurance, and technical assistance by government-created research institutions. Taiwanese SMEs were dynamic and responded strongly to these policy initiatives.
- ❑ Unlike Japanese MITI, policy drafting and stakeholder consultations were outsourced to government-created think tanks—the Taiwan Institute of Economic Research (TIER) and the Chung-Hua Institution for Economic Research (CIER).

Taiwan's Current Industrial Policy Instruments



Industrial Technology Research Institute

Taiwan's policy instruments have been streamlined to a few (no more incentives for export, investment, training, etc.) The policy structure is simple but effective.

- ❑ **Technology institutes** offering excellent support in technology and networking (ITRI and sectors: metal, food, plastic, automobile, IT, precision machinery, etc.)
- ❑ **Science parks, EPZs and industrial parks**—only firms that do intensive R&D are allowed in science parks
- ❑ **Industrial Projects**—comprehensive hands-on technical and financial support for selected firms to commercialize new products

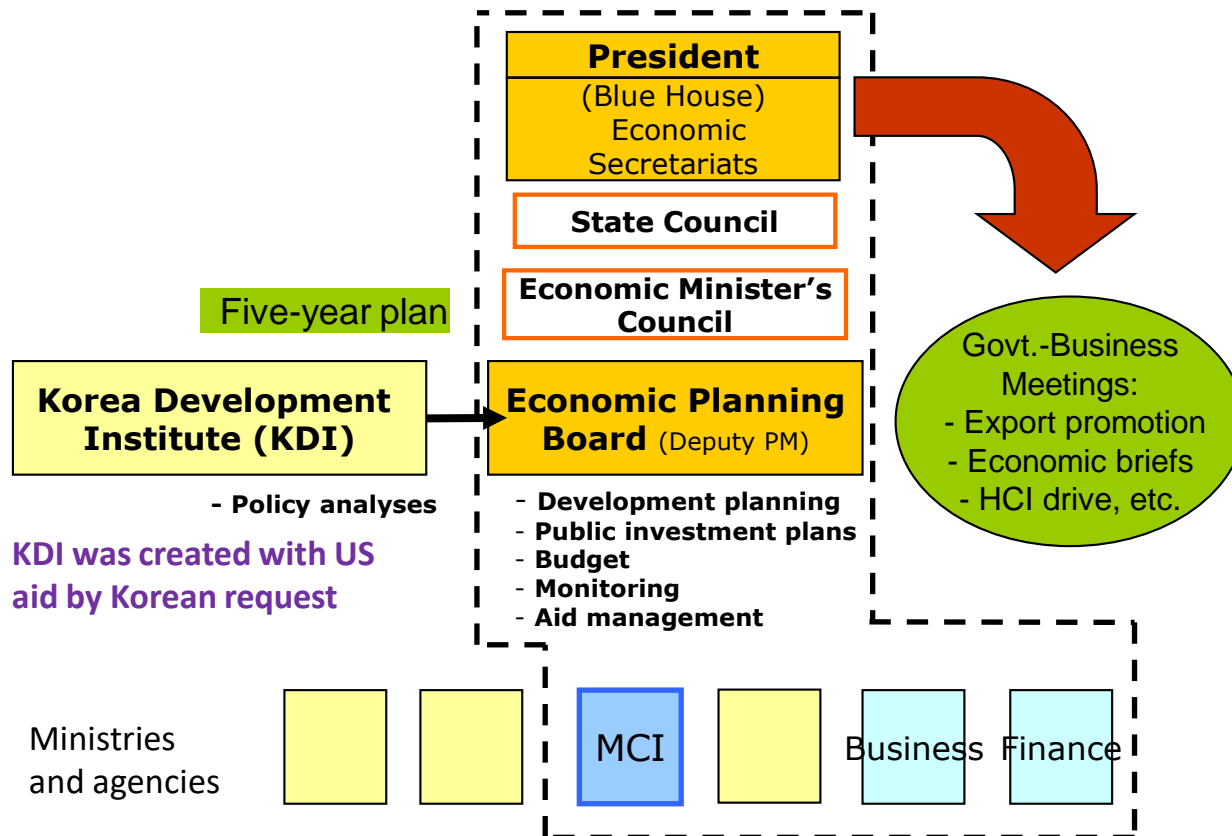
Taiwan also offers comprehensive SME support.

MoEA officials are competent, friendly and without red tape.

South Korea: 1960s and 70s

- ❑ Korea was devastated by the Korean War (1950-53). Compared with North Korea, South Korea was poor and without natural resources. **Politicians and bureaucrats were incompetent and corrupt.** The economy was barely surviving with US aid. Very few imagined that growth was possible in this country (World Bank 1993).
- ❑ Park Chung-hee's military coup in 1961 transformed South Korea greatly. He established the Economic Planning Board and drafted five year plans. Incompetence and corruption were eliminated.
- ❑ **1960s:** under state guidance, chaebols (large corporate groups) such as Samsung, LG and Daewoo promoted export. Technology and finance were imported. Government dictated fund allocation.
- ❑ **1970s:** heavy industrialization became a new goal. Chaebols were engaged in steel, automobiles, shipbuilding and electronics. **By then, Korean bureaucracy had become highly reputable.**

Korea: Policy Making Under A Strong President (1960s-70s)



KDI was created with US aid by Korean request



- President Park Chung-hee directly controls economic policies
- EPB acts as a super-ministry
- Research institutes (KDI and others) provide analyses
- Very close and cooperative gov't-business relationship
- Performance-based rewards and penalties

President Chairs and Rewards High Export Achievers



Monthly Export Promotion Meeting chaired by President Park (late 1960s)



President Park confers medals and great honor to firms with excellent export performance

Korea: Saemaul Undong (New Village Movement): 1970s



- ❑ President Park launched a top-down massive rural transformation movement in 1970. Mindset, lifestyle and income were targeted.
- ❑ Every Korean village received 13.4 tons of cement for use in communal projects. They were graded by results. Assistance was continued only to high-performing villages.
- ❑ Central government supervised lower-level offices and village committees. Material, financial and technical support was provided. Project selection, evaluation and training were institutionalized.
- ❑ Some criticized the movement as a political device for justifying Park's rule. But the result was extra-ordinary. As Korea grew fast, its rural sector grew even faster than the national average. The urban-rural income gap narrowed significantly.