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Industrialization: Key to Development in East Asia and East Africa

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INDUSTRIALISATION KEY TO DEVELOPMENT IN EAST ASIA AND EAST AFRICA

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TABLE OF CONTENTS

LIST OF TABLES III

1.0 INTRODUCTION 1

2.0 WHY AND WHAT INDUSTRIALISATION? 2

2.1 INDUSTRIALISATION - THE ONLY WAY OUT FOR AN AGRARIAN ECONOMY 2

2.2 INDUSTRIALISATION ENHANCING DYNAMIC COMPARATIVE ADVANTAGES 3

3.0 ROLE OF THE STATE 7

3.1 ACTIVE OR PASSIVE? 7

3.2 FORMULATION OF INDUSTRIALIZATION STRATEGIES 9

3.3 PROPER FUNCTIONS 13

4.0 POLICIES AND MEASURES 18

4.1 PREPARATION OF PRECONDITIONS FOR TAKE-OFF 18

4.2 FACTOR DEVELOPMENTS 23

4.3 GROWTH OR DEVELOPMENT? 29

4.4 POVERTY ALLEVIATION 33

4.5 FOREIGN ECONOMIC POLICIES 36

5.0 FINANCIAL CRISIS AND REASSESSMENT OF EAST ASIAN MODEL 42

5.1 THE CRISIS 42

5.2 REASSESSMENT OF THE EAST ASIAN MODEL 46

6.0 CONCLUSIONS, FINDINGS AND IMPLICATIONS 49

REFERENCES 51

LIST OF TABLES

Table 1: Personal taxes in selected Asian and Western countries 24

Table 2: Gross domestic savings as % of GDP 24

Table 3: Annual work hours and paid holidays of selected Asian and European ....
cities 28

Table 4: Life expectancy in Asia 32

Table 5: East African Countries' Selected Indicators, 2000 33

Table 6: Changes in percentage of population below poverty line in Asia 35

Table 7: Korea's business cycles..44

1.0 INTRODUCTION

This paper is a part of the Globalization and East Africa Project, so its main aim is to contribute to the development of East African countries. Since these countries are now among the least developed countries in the world, they need to learn from the experiences of the more successful countries, particularly the developing ones which started their development process from the same situation as that of the East African countries and have got better achievements than the East Africans. Among the successful cases are the East Asian developing nations whose experiences and lessons are worth to be considered by the East African countries. However, their experiences and lessons are so many that this paper is unable to cover. The choice is, therefore, to focus on *the single most important issue* that the East Asians have successfully experienced and the East Africans need to develop, that is, *industrialization*. In order to do this, the paper will first try to find the answers to the two questions raised in Chapter I: why do East African countries need to industrialize and what industrialization would be best for East Africa? It then moves to study the role of the State in Chapter II as the designer and the leading factor in the implementation of industrialization strategies in the market economy where market forces greatly influence the development process. Chapter III discusses the policies that are necessary for the fulfillment of industrialization such as the preparation of the preconditions for take-off, the development of production factors like capital, technology and labor, the balance between economic growth and social development, the alleviation of poverty, and the foreign economic policies with particular reference to the role of foreign trade, investment and aid. Chapter IV will look at the financial crisis as the largest feedback of the East Asian model and the reassessment of the model itself as an aftermath of the crisis. Finally, some cconclusions, findings and implications will be presented in Chapter V. Since the analysis concerns the two groups of countries, it will follow a comparative approach whereas the cases of both regions are to be relevant.

2.0 WHY AND WHAT INDUSTRIALISATION?

2.1 Industrialisation - the only way out for an agrarian economy

The new fashion in Western economics has in recent years turned to the *"new economy"*, to *IT* and/or to the *knowledge-based economics*, thus *development economics* which has long been discussed since the 1950s and focussed mainly on developing economies (DEs) has now seemed to be out of fashion and less concerned. But for most of the present hundred DEs, the latter is still far more important than the new economy, IT or the knowledge-based economics as the DEs are still greatly in need of *industrialisation* which has been proved to be the *key element* and *the only way* to help bring their economies out of the current status of agrarian, poor and backward situation. Development economics is also far more developed by itself because of its continuous, successive and updated *changes of focus* from *growth* to *development*, and recently, to *sustainable development* which embraces not only economic growth, but also social development and environmental protection, though not yet much new and high technology. Development economics is, therefore, still needed to be discussed and developed, particularly by economists from developing countries for the sake of their own countries' development. IT, e-commerce, e-banking, the knowledge-based and new economics, along with globalisation and liberalisation, are of course included as new factors of development, though with a lower degree compared to developed nations.

After fifty years of development since the Second World War or since the liberation of most developing countries, few dozen of these countries, mostly in East Asia and Latin America, have been able to move ahead and become industrialised or newly industrialised, while the majority of them, particularly the African countries, lag behind, remaining almost as poor and backward as those "Third World" countries fifty years ago with around 70-80% of their population continuing to live and work in agriculture and in rural areas, GDP per capita income grew from roughly $100 to just $200 or $300, and about half of their population living below the poverty line. The "Third World" countries have thus been differentiated into three classes, the first group which includes a small number of countries became industrialised and joined the developed world (like South Korea joined OECD countries, for instance), the second and also small in number became newly industrialised, while the rest remain developing countries. In accordance with these three groups, *three generations*

of industrialisation have emerged in Asia and Latin America, without any one coming from Africa, except South Africa, to join them. In Asia, the first group is made up of Hong Kong as a territory of China, Singapore, South Korea and Taiwan (a province of China), if Japan is to be considered as the earlier comer and not included in this group. The second group of Asia appears to be Indonesia, Malaysia, the Philippines and Thailand. And the third group which is currently identified as emerging or transitional economies, including China, India and Vietnam. East Africa, including Kenya, Tanzania and Uganda, has not yet joined these three groups. Should East Africa joined the *fourth generation of industrialisation* of DCs? If yes, how to? And by what means?

2.2 Industrialisation Enhancing Dynamic Comparative Advantages

The answer to the above questions for the East African countries will be made first of all by the East Africans themselves. However, half a century of experiments of development in East Africa has proved that all the selected choices of inward-looking, self-reliance, Basic Industrial Strategy, Basic Needs, Structural Adjustment Programs, aid dependency, and others, all did not help. Then what should it be next?

Tracing back to the 1950s we might recall that it was not only Africa that has made some faults, Asia had also made several bad choices as well. Though in Asia today, particularly during the period from the mid-1960s since the start of the export-orientation strategy to the financial crisis of 1997-98, most people talked about their success, appraising it as the miracle in development, but when addressing this, they simply forgot about the not-a-few unsuccessful choices the Asians have made such as the heavy-industry-based strategy copied from the former Soviet model, the import-substitution strategy adopted prior to the export-orientation strategy, and the mixed model adopted in India from the 1950s to 1990. The main lesson from these failed choices was that these countries either based their strategies on their subjective expectation or on the conditions not of their countries' available comparative advantages, e.g. the resources to build heavy industries, particularly they overstressed their internal factors and, in some cases, over-expected the assumedly large Soviet aid.

Recent studies of East Asian economies have suggested that only when these countries turned to choose the strategies that have efficiently utilized their comparative advantages that they have been successful. This was clearly illustrated

in *H. Edward English's* paper entitled "*Dynamic Comparative Advantage - A Basis for Industrial Policy*" (p. 12).when he pointed out 6 features of the utilization of the basic advantages in South East Asia, including:

(i) Resource intensity;
(ii) Ethnic pluralism, variety of cultures and skills;
(iii) Geographic dispersion - diversity of interests;
(iv) Experience with colonialism;
(v) A substantial regional market; and
(vi) The acceptance of external economic partners.

Edward English's finding of "resource intensity" was later further developed by *Ross Garnaut and K. Anderson* into *four enlarged categories* as follows:

(i) Resource-based industries with relatively *low* capital (and *high* labor) inputs;
(ii) Resource-based industries with relatively *high* capital (and *low* labor) inputs;
(iii) Non-resource-based industries with relatively *low* capital inputs; and
(iv) Non-resource-based industries with relatively *high* capital inputs.

The above findings of "resource intensity" and "resource-based industries" by *Edward English, Ross Garnaut and K. Anderson* remind us of the utilization of the comparative advantages of a nation, particularly a developing one as currently being discussed in this paper. Since these comparative advantages keep changing as the passage of time, they need to be looked in a *dynamic* process and to be redefined at each stage of development. For instance, the most important production factor has been changed from land and natural resources under the agrarian economy to that of capital under the industrial age, and is likely to be replaced by the knowledge under the new or knowledge-based economy which has been fast and increasingly developed during the last decade or so. Observing the development process of the currently developed countries, these changes have been apparently evident: At the beginning of the 20th Century science and technology made up only from 5 to 20 percent of the total value of their GDP growth; to the 1950s and 1960s this percentage was raised to 50 percent, since the 1980s it continued to rise to 80 percent and over; and currently information technology and knowledge has gradually moved up and in a position to replace the content of science and technology in GDP growth. In the United States, for example, IT has already made up of around 30 percent of the value of their GDP growth. The same trend is now being developed in Europe, Japan, South Korea and other developed countries.

As far as developing countries are to be concerned, their most important advantages are presently composed of the five crucial factors such as natural resource endowment, labor, capital, technology and the market capacities with the last includes the size of their population and their GDP per capita income or their purchasing power (Dinh, 1999). In the case of East Asian nations, these advantages have passed three stages of quality change in accordance with the changes in the three stages of their development during the process of half a century since the 1950s. Under the first stage from the 1950s to the end of the 1980s their industrialization was still at its low level or at the beginning of their take-off, the most important factors in use were natural resources and low-cost labor, and in accordance with this the labor-intensive and natural-resource-intensive industries, particularly export-oriented industries, were developed. During this period, some capital- and technology-intensive industries, mainly in the area of economic infrastructure, such as power, chemicals, telecommunication, electronics, financial and banking services, were developed, but they were small in number and mostly developed on a selected base as the preparation for the second stage.

To the second stage which was projected from the 1990s to around the year 2020 by the 5 more developed Southeast Asian countries including Singapore, Malaysia, Thailand, Indonesia, and the Philippines, such factors as cheap labor, natural resources and agricultural products have gradually lost their comparative advantages, while new factors with new advantages as capital and technology have been increasingly developed both in terms of quantity and quality. In parallel to this change, the economic structure has also changed in such way as to increasingly utilize the new advantages in combination with the enhancement of the already available ones. Under these new conditions, the capital- and technology-intensive industries have been increasingly developed, including some more advanced industries and modern services of higher value-added content. This explains why in the economic structure of these countries, the share of agriculture has dropped sharply, usually from 70-80 to 10-20 percent of GDP, while the shares of industries and services gone up from 10-20 to 30-40 percent, and 20-30 to 40-50 percent or more, respectively. This development proves a new trend of modern industrialization in which the economic structure not just shifts from an agrarian to an industro-agrarian one as it was the case of the classical transformation, but also to a new structure of industry-service-agriculture, or service-industry-agriculture as it occurred in a number of Asian developing economies among which Taiwan is one of the typical cases.

In the new context of globalization and in face of the new or knowledge-based economy, these countries have in recent years paid more attention to the developments of higher human resource and high-tech, especially IT industries to meet with the new requirements of the third coming period of their development whereas they may join as members of the group of developed countries.

All the facts above prove the largest reason behind the success of most of the East Asian developing economies, especially the Southeast Asian ones, that is, the *industrialization that enhances the dynamic comparative advantages* of these economies.

For the East African countries, the main cause of their unsuccessful development so far has been that they *lack this very crucial industrialization* which plays the *key role* in developing economies' development. Most of what they have done were structural adjustment programs and plans aiming to solve the immediate pressing problems such as the "basic needs" scarcities, the "survival" from shortage, the rehabilitation from crisis, which were of short-term rather than long-term purpose. The question here is whether they are now to make the choice to follow this *Strategy of Industrialization Enhancing Dynamic Comparative Advantages* and join the fourth generation of industrialization or not? If the answer is yes, and in order to do so, the first thing they need to do is to raise the *visible hand* of the State.

3.0 ROLE OF THE STATE

3.1 Active or passive?

The European countries and those in Asia, Africa and Latin America started their industrialization process in a different situation, e.g. the former started it at a time when there had been no earlier examples, while the latter already witnessed the experiences developed by the former since the 18th and the 19th centuries. This different context identifies the difference in the pattern of industrialization of the two groups of countries. In order to understand this difference, *C. Gunnarsson* used the *8 pairs or dichotomies* discovered by *Gerschenkron* from the latter's study of European history of industrialization as the tools to compare the industrialization process developed in Europe to that of Asia *(C. Gunnarsson, p.191)*. And from this comparison, following findings were made:

1. With the first pair of a***utochtonous or derived*** industrialization, distinction was made that Europe was basically more on the first, basing more on the endogenous than exogenous factors, or more self-centred than "dependent" industrialization; while Asia was more with the second, e.g. more of a derived pattern.
2. In comparing whether the industrialization in each of the groups was ***forced or autonomous***, the finding was that Asia was more on the first, more forced or more *active*, with the State playing a more direct role as a regulator and/or an actor on the market; while Europe was more on the second, more *passive*, with the changes in legislation following the changes of the market forces during the industrialization process.
3. The third comparison was on the focus of production whether each group ***concentrated on producers' goods or consumers' goods***, more on the demand or supply side. The finding was that Europe followed the pattern of complementation by both; whereas the former Soviet Union, China, Vietnam and India, prior to their reform, were on the extreme exception, more on the demand side, that's why they were unsuccessful; in contrast, Asia was more on the supply side and by so doing they were highly successful.
4. Concerning the question whether industrialization in Europe and Asia ***occurred in an inflationary or stable monetary environment***, the answer is that both Europe and Asia are mostly stable.
5. Another issue is whether each of the groups ***involved merely quantitative changes or being in addition characterized by structural changes***, the finding is that both Europe and Asia are mostly combined.

6. As regards of the process of industrialization whether it was ***proceeding continuously or discontinuously*** in Asia and Europe, the reply is that both were basically continuous, however each is characterized in a different style: Asia proceeds continuously but with short and smaller pauses, usually once in ten or fifteen years, such as the 1973-74 oil shock (high oil price), the 1981-82 debt crisis, and the 1997-98 financial crisis; while Europe basically continuously in much longer period of time (two centuries), but faced the two very big discontinuities, e.g. the two great recessions during the 1st and the 2nd World War.
7. Relating to the development of agriculture, the question is whether one group or the other ***proceeded in conditions of progress in agriculture or of stagnation of agriculture***, results were mixed as the concept of balanced growth of both agriculture and industry is not highly appreciated, Gunnarsson for instance considered it a "distortion" (*Gunnarsson, p.198*), and in fact this is not quite clear on the role of agriculture when we come to concrete cases: in Korea and Taiwan, for example, modernization of agriculture were found good, and in Malaysia it was the same for rubber's high yielding varieties, but in Pakistan, India and Indonesia the results were not the same.
8. The final pair is on the purposes of industrialization whether it was ***motivated by economic or political aims***, which concerns the motives behind the State involvement, be it the protection of class' interests as described in the Marxian theory, the protection from external threats, and/or other reasons. Of this Europe was found more with the economic reason, while in Asia both economics and politics appear on the scene, with most developing economies are of the economic end in accordance with which the State acts as the leading actor in industrialization, Malaysian P.M. Mahathir Mohamed, for example, chooses to do politics by doing economics, hence more successful, in the mean time few other countries stress on politics, as a result they were less successful.

It is clear from the above discussion that there is a difference between Europe and Asia as regards of the role of the State in the process of industrialization. In the former's case, the State was *passive*, it follows the process of industrialization and makes the changes of legislation in accordance with the changes of the market forces and the industrialization process. In the latter's case, the State has been more *active,* it not only involves in the formulation and enforcement of legislation, but also plays the role of direct engagement and guidance in the process of industrialization, and

by so doing, the State has helped, as in the successful cases, shorten the period of industrialization to about six decades as it was achieved in Japan or four decades in South Korea, instead of two centuries as it was in Europe.

The similarity between East Asia and East Africa concerning the role of the State in the process industrialization is that both groups of countries start their industrialization when there was already the experiences from Europe, so the State should be active in both groups of countries to lead the industrialization or development process. But in practice, the two groups have not followed the same pattern. The difference is that while East Asia has learned the European experiences and selected the choices by themselves for themselves which have been appropriate to their conditions, and thanks to that they have been successful; East Africa has however not made the same choice, they have usually followed the "advices" offered by aid donors which have been tied more to donors' invested interests than to local conditions, hence the East Africans have been unsuccessful. In other words, comparing to East Asia, the State in East Africa has been *less active* than it should be to lead the transformation of their agrarian and backward economies to be industrialized or newly industrialized as it has been done in East Asia. And because of that, "In Africa, [as Professor *Brian Van Arkadie* put it], the introduction of structural adjustment reforms [mostly initiated by aid donors] had coincided with a sad decline in the capacity of governments to carry out required tasks", while "…the important role of the State was the recognition that a key characteristic of the successful economies of East Asia was that a buoyant private economy was supported by coherent and effective State action" (*Brian Van Arkadie*, 2002, pp. 7, 8, 9).

3.2 Formulation of industrialization strategies

One of the most important tasks of the Government in a developing nation is to formulate an appropriate strategy of industrialization for the nation and lead the nation, including the Government as a participant, to successful implementation of that strategy.

Actual developments in East Asia and East Africa have shown that there are similarities and differences in the industrialization strategies adopted by countries in the two regions. Like in East Africa where there have been inward- and outward-looking strategies as the Basic Industrial Strategy, Basic Needs, planned economies, SAPs or aid dependency, there have also been in East Asia inward- and outward-looking strategies whose names may be different such as import-substitution, self-

reliant, heavy-industry-based, export-orientation, planned economy and mixed economy. The largest differences lay in the clearer vision, the more effective management and the far more successful implementation of East Asian strategies compared to those in East Africa. Today it seems that most people appreciate the export-orientation strategy for its unchallenging successes and ignore or underestimate the others. But in practice, each of the strategies has played its historical role, though some may be more successful than the others. Even the export-orientation strategy has since the break-out of the Asian financial crisis in 1997-98 faced critical re-assessment. Hence there has been call for re-formulation of development strategy in Asia and other developing regions. After the Asian financial crisis, the Thai Prime Minister, for instance, called for the greater mobilization of internal forces, and because of that he was questioned by foreign investors whether his country would continue to rely on foreign investment or not.

This situation suggests the necessity to trace back to these strategies to see how each of them performed.

The first strategy that most of the Asian developing economies adopted during the 1950s and the 1960s was the *import-substitution strategy* which was formulated at a time when the old colonial countries were driven from the young independent States of Asian nationscarrying away a large part of their industrial facilities, leading these newly liberated nations to build their own economies as the foundation of their political independence. The choice they made at that time was the development of their domestic potentials, including the building of local industries, the mobilization of internal savings, the development of domestic markets, through the nationalization and protection measures. This strategy played a very important historical role during this initial stage of their industrialization, it set up the national industrial bases and the infrastructure of the countries, it helped the new Governments in these countries to practice their newly independent national economic policies. However, to the mid of the 1960s, it was found that these industries were not efficient due to the insufficient economies of scale, the lack of market for their products, the shortage of capital and modern technologies, the increased trade deficits due to the larger imports of machines and intermediate goods compared to the small amount of exports. To overcome such difficult conditions, most of these countries had timely changed to the export-orientation strategy since mid-1960s.

The *export-orientation strategy* became therefore their second industrialization strategy that replaced the previous import-substitution one. This new strategy was, instead of relying heavily on the internal factors, exposed to the international markets for capital, modern technologies and the outlets for their products, among other things, through export incentives and foreign direct investment (FDI) attraction. Since then this strategy has brought East Asia tremendous achievements that it has been appraised as the most successful strategy since the mid-1960s to the present time, though certain feed-backs occurred during the Asian financial crisis of 1997-98.

Beside the above two mainstream strategies that most Asian developing economies adopted there have been some other strategies which were not as popular as the above, notably the *centrally planned economy* and the *mixed economy* with the first defined as the socialist and the second as half-socialist-half-market economy. Though these economies were not formally named "strategies", they might be treated as strategies because of their long-term plans and strategic nature. Both of these two strategies started from the 1950s with China, Vietnam and North Korea in Asia adopted the first and India the second. Though these strategies have in fact helped the countries adopted them to build to certain degree necessary industries and infrastructure, they failed in mobilizing sufficient capital, modernizing technologies, developing competitive products, and worse even, they led to serous imbalances and shortages, so they were recognized not very successful, as a result the countries that followed them have had one by one to change, with China formally changed since 1978 under the reform and open-door policy, Vietnam since 1986 under the policy of renovation, India since 1991 under the policy of reform and liberalization, and North Korea being currently changed starting from the cancel of coupons.

The review of the above strategies helps make clear that the most successful strategy is the one that have made the best use of comparative advantage - the export-orientation - which has been able in around four decades to combine the internal and external factors of a country in the development of their competitive industries for both the domestic and the international markets; while the others were less successful or failed to succeed because they either focused so much on the factors of non-comparative advantage (basic and/or heavy industries), on the demand side rather than the supply side (the basic needs…), or overstressed the internal rather than external factors (inward-looking or self-reliant). To date, however, even the most successful export-orientation strategy has been questioned and reassessed for it went too far to bias on the external factors which resulted in the 1997-98 Asian

financial crisis. These developments suggest that in the new situation a new industrialization strategy for developing economies, particularly the later comers like the East African ones, is needed which would firstly and necessarily avoid bias and develop a new balance between the internal and external factors, and secondly to meet the new conditions, e.g. to grasp the opportunities and to overcome the challenges brought about by globalization, liberalization and the emerging knowledge-based economy. That new strategy should be the one which is able to promote the dynamic comparative advantages of developing nations, and because of that it may be named as *the Strategy of Industrialization Enhancing Dynamic Comparative Advantages (SIEDCA).*

The *SIEDCA* is supposed to be developed basing mainly on the following 5 pairs of comparative advantage:

Pairs	Low Comparative Advantages	High Comparative Advantages
1	Simple labor	High quality labor
2	Traditional materials	New materials
3	Small and medium capital	Large capital
4	Appropriate technology	New technology
5	Low purchasing power	High purchasing power

Of the above five pairs of comparative advantages, the meaning of the first four is quite clear to all economists today. Only the final pair needs some more deliberation because of the misunderstanding due to the overstress on the internal content of the market of developing economies since the 1960s and the 1970s basing mostly on the size of the population. It has been recognized recently that the determining factor of the capacity of a market is more of the *purchasing power* than the population size, even though the latter may play an important role. This fact explains why Singapore with a population of roughly three million people has in recent years had an annual trade value of about US$200 billion, as much as twice of the US$100 billion trade value of India whose population is of over a billion people. The reason is that Singapore's average per capita income already reached US$2700 while that of India is still less than US$400 in which only about 10 percent of the Indian population is able to buy durable family consumer goods as an average family in Singapore.

Among the comparative advantages referred to in these five pairs, the *low* ones are available as dominant factors in most of DEs when their GDP per capita income is below $2000, then the *high* ones take over the dominant position when DEs' GDP per capita reached $2000 and over. This evolution of change from low to high comparative advantages suggests in the first place that *SIEDCA* needs to be carried out in *two stages* with different emphases at different steps, e.g. enhancing mainly the

low comparative advantages during the *first stage* with an aim to build a *Newly Industrialized Economy (NIE),* whilst preparing conditions for high comparative advantages to emerge and to be utilized for the purpose of building an *Industrialized Economy (IE)* at the *second stage*, which would be followed by the *knowledge-based economy* as the post-industrialization stage of development. Under this pattern of industrialization, SIEDCA may be used as a means to help shorten the industrialization process as Japan and the NIEs have done.

The second feature of SIEDCA is that it would not be carried out in separate sets of policies of export-orientation or import-substitution, instead it would be implemented through the *complementation or combination of export-orientation and import-substitution policies* with the former as strategic and long-term, and the latter short-term in necessary cases. This is a more balanced strategy which reconfirms the long-term decisive role of internal factors with the external as important supplements. This is an *alternative* to both the export-orientation which was heavily biased on external dependency (Hirsh: "bias of hope"!) and the import-substitution which overstressed the internal factors or self-reliance. In face of the fierce competition and the new developments of globalization, liberalization and the knowledge-based economy, bias on either side, self-reliance or external dependency, would be equally vulnerable.

Bias has also been exposed in East Africa, but not strategic bias because these countries have never developed their own strategies like those in East Asia. The bias of East African countries often relates to the reforms, particularly the structural adjustment programs (SAPs) having been carried out since the mid-1980s, following the donors' "advices" or design. Their bias is characterized by the heavy dependency on foreign aid, the over-reliance on the State under the "control regime" during the 1960s and 1970s, and currently the retreat of the State from the market economy in favor of the private sector under rapid capital-market liberalization and privatization. If industrialization is to be identified as the main path to development, the biases taken place in East African countries prove that they have all been off-track of industrialization. Should these countries realize this and move to the track, or should someone brings the track to them, the reply is yet confirmed.

3.3 Proper functions

After the strategy was set, who will be the one(s) to realise it and to realise in what way? Would that be the State, the market, or both? So far, at least three alternatives have been developed in theory as well as in practice. The structuralist school or structuralism which appeared first in Latin America in development economics since

the 1950s advocated the dominant role of the Government in the DEs; while the neo-classical theory or neo-liberalism which was developed since the mid-1960s, particularly the so-called Washington consensus, suggests the minimal role of the State and bolsters the influencing principles of the market. East Asian experiences have proved another alternative, that is, the leading role of the Government in the market economy along with the influencing performance of market forces, hence the coherent association of the two. The practical experiences of East Asia during the last half a century have convinced most economists of the important roles of both the Government and market forces in the market economy, particularly in the economies of developing countries where the process of industrialisation having been carried out. The main concern nowadays is therefore not the dominance of one over the other, the Government or the market, but the proper role and functions of each, especially the role and functions of the Government in the market economy. To make this clearer, in the coming parts of this study, further analysis of the East Asian experiences concerning the role and functions of the Government in the market economy during the last fifty years will be deliberated.

To date analysts of East Asian developments have confirmed the necessity of the *important role* of the Government in DCs' market economies as a means to overcome their backwardness (*Gerschenkron*), but instead of addressing the dominant role of the Government, they called for a *"market creating"* (*K. Kojima, p.5*) and *"market-facilitating* rather than market-inhibiting" State (*Mohamed Ariff and Hal Hill, Source: R.G. Gregory, p.4).*

Robert Wade in his well-known book entitled "*Governing the Market: Economic Theory and the Role of Government in East Asian Industrialisation"* published in 1990, has identified the following *types of theory, functions and areas* concerning the appropriate role of the Government in Asian market economies.

As regards of theory, *Robert Wade* classified the *3 principal types* which are worth to be summarized (*see Chapt.1*):

(i) The first type he described as the *"Free Market (FM) Theory"* which is characterized by the features such as:
   - The State provides a suitable environment for the entrepreneurs to perform their functions;
   - The State directs the resources to desired channels;
   - The State relies extensively on private markets rather than heavily on central planning;
   - And the State lessens the Government interference.

(ii) In the second type, the *"Simulated Free Market (SM) Theory"*, the State's role is:
- To do more than just liberalizing markets and lowering distortions;
- To intervene more positively to offset other distortions (import controls, segmented financial markets,…);
- To apply moderate incentives very close to relative prices in free trade;
- And to carry out what he called the "great value" interventions including (1) export promotion, (2) trade liberalization, and (3) macroeconomic stabilization.

(iii) The third type *Robert Wade* defined as the *"Governed Market (GM) Theory"* which is, in his words, equivalent to the concept of *"Capitalist Developmental State"* developed by *Chalmers Johnson* or the term *developmentalism* or *developmental State* often referred to in development economics literatures. Of this type *Robert Wade* stressed the following characteristics:
- The directive role of the State like in the case of South Korea;
- The State as a participant that has the determining influence in the market;
- Private enterprises operate under highly centralized government guidance;
- The Government's hand reaches the activities of individual firms through its incentive and disincentive measures.

Of these three types of State, *FM, SM (i and ii)* are referred to, in *Robert Wade's* definition (Pp.28-29), as "small followership" or "small leadership" State, while *GM (iii)* is defined as "big followership" or "big leadership" State.

Basing on the neoclassical point of view, *Robert Wade* found out that the Governments in East Asia have done well in the market economy, because they have adopted the six most *essential functions (pp.10-11),* including:

(i) Maintaining macroeconomic stability;
(ii) Providing physical infrastructure, especially that which has high fixed costs in relation to variable costs, such as harbors, railways, irrigation canals, and sewers;
(iii) Supplying "public goods," including defense and national security, education, basic research, market information, the legal system, and environmental protection;
(iv) Contributing to the development of institutions for improving the markets for labor, finance, technology, etc.
(v) Eliminating price distortions which arise in cases of demonstrable market failures;
(vi) And redistributing income to the poorest in sufficient measure for them to meet their basic needs.

More specifically, *Robert Wade* pointed out *7 areas where the Government guided markets* in East Asia *(p.27).* Those areas are:

(i) Redistribution of agricultural land in the early postwar period;
(ii) Taking control of the financial system and making private financial capital subordinate to industrial capital;
(iii) Maintaining stability in some main economic parameters (exchange rates, interest rates, general price level…) that affect long-term investment;
(iv) Modulating (regulating) the impacts of foreign competition on the domestic economy and prioritizing the use of scarce foreign exchange;
(v) Promoting exports;
(vi) Promoting technology acquisition from multinationals and building national technology system;
(vii) Assisting particular industries on a selective basis.

Apart from *Robert Wade,* some other authors also deliberated several concrete features and functions of the State in the market economy of East Asia. *C. Johnson,* for instance, referred to a model which is characterized by the following *main features of developmental state:*

(i) The top priority of State should be given to economic development, particularly the definition policy purposes concerning growth, productivity and competitiveness, rather than welfare;
(ii) The State commits to private property and the markets, limiting its intervention to those areas;
(iii) The State guides the markets with instruments formulated by bureaucrats, technocrats…;
(iv) The State needs to consult and coordinate with the private sector;
(v) The State follows a mechanism in which bureaucrats "rule", politicians "reign" through "soft authoritarianism", responding to needs of interest groups and political party(s), and maintaining the needs of economic development vis-a-vis other claims, hence stability.

The last but not least impressive model or *"formula"* referred here is the one that was drawn by *John M. Leger* resulting from his analysis of the 20 years of growth in East Asia *(FEER, November 24, 1994):*

Hard Work
+Low Taxes
+High Savings Rates
+Minimal Government
= Economic Boom

To this point, it is evident that the East Asian experiences have helped clarifying the fundamental role, the essential functions and the main areas of activity that the State needs to perform in the modern market economy. However, as Robert Wade stressed after analyzing these issues, though most people today generally agree upon those functions, role and areas, there is still a lot of controversy concerning the actions of the State, due to practical proper and improper policies and measures adopted by varying countries, particularly those policies and measures relating to the financial liberalization and privatization, resulting in different gains and losses. The East Asians have been more successful because their financial liberalization was carried out without interrupting the continuous maintenance of their monetary (price) stabilization, the deepening of their financial reforms and the gradual liberalization of the capital market activities of their commercial banks; while the Latin Americans (Chile, Uruguay, Brazil, particularly) failed due to the rather complete deregulation and privatization, and the uncontrol of high and unstable inflation throughout the process of their financial liberalization.

These differences in action, hence different results, imply different choices for the East African countries. 40 years since their independence to the present time the East African countries, particularly Tanzania, have adopted two principal forms of economic management which reflect the transformation from one extreme to the other, that is, the previous administratively-centralized-management system prolonged from the second half of 1960s to the first half of the 1980s, and the current market-oriented economy in transition. These two forms look somewhat similar to the GM and FM models, but have been loosely managed, thus yielding very marginal success. To date the new choice is needed to be made, whether they follow the FM, SM or GM models, or they select certain functions and areas of activities for their good performance or good governance, all depend firstly on their own concrete conditions. Outsiders', particularly the aid donors' help, would bring fruitful results only when this help associates with the proper choice of the local governments and their people. Otherwise, failure prevails.

4.0 POLICIES AND MEASURES

4.1 Preparation of Preconditions for Take-Off

In theory, the idea of preparation of preconditions for take-off was first raised by *W. W. Rostow* in the early 1960s in his two books, e.g. the "*Stages of Economic Growth*" and "*The Process of Economic Growth*" (1962) in which he recommended the five stages of economic growth, including (1) the traditional society, (2) the preconditions for take-off, (3) the take-off, (4) the mature or industrial society (in technological term), and (5) the consumptive or post-industrial society, but in practice the experience of precondition preparation was developed in Asia as early as since the period of 1868-1885 under the Meiji Era of Japan.

Tracing back to the process of modern economic development in **Japan**, Professor *Yoshihara Kunio,* in his well-known book entitled "*Japanese Economic Development*" published the third time in 1994, divided the "historical course of development" of Japan into 8 periods[1], in which the first 17 years of the Meiji Era was the period of preparation. Under the title "*laying foundations for a modern economic system*", Professor *Yoshihara Kunio* described the main characteristics of this preparation period (1868-1885) as of two fold: the first set of activities was the break-out of the old feudal regime characterized by two main features, e.g. the destruction of the fetters of feudalism and the transition into a new economic age; the second set included the setting-up of a political integration system from the decentralized Tokugawa regime and the building of a modern capitalist economic system from feudalism. The most important policies and measures implemented in the second set of activities included:

- The modernization of the monetary and fiscal system through the tax reform in which the old regime of "tax in kind" was replaced by the modern monetary tax, the setting of the yen as the basic monetary unit, and the building of the central bank (Bank of Japan);

- The recognition of private properties under which taxpayers became the legal owners of property;

- The development of education;

[1] These 8 periods are: (1) 1868-1885: Laying Foundations for a Modern Economic System; (2) 1886-1911: Economic Take-off; (3) 1912-1936: Rise of Heavy Industry; (4) 1937-1951: War and Occupation; (5) 1952-1973: Post-war Economic Expansion; (6) 1974-1984: Overcoming the Oil Shocks; (7) 1985-1992: Recent Economic Changes; and (8) Future Prospects (See Chapter 1, pp.1-34).

- The adoption of modern Western technologies by importing machines and inviting foreign technicians to Japan;
- The building of the infrastructure including railways, sea transportation, and the modernization of the communication network;
- And the development of modern enterprises, including joint-stock companies.

The introduction of those policies and measures were considered as the preparation of the preconditions for the successive period of "economic take-off" to follow in Japan from 1886 to 1911.

In **South Korea** the preparation of preconditions for industrialization or take-off took place in a much later period, from 1953 to 1960, under the post-war reconstruction policy. During this period the South Korean Government adopted the import-substitution strategy under which three main sets of policies were carried out through the *building of the infrastructure*, including roads, ports, airports…; the *implementation of the stabilization policy*, particularly the stabilization of price, the control inflation (resulting in the reduction of inflation from 531% in 1951 to 30% in 1956), the replacement of the multiple exchange rates by a single market rate, the increase of the interest rates in an attempt to raise the low level of investment which was around 10% of GNP, the reduction of money supply from 62% in 1955 to 20% in 1957; and the *construction of selected infant industries* which were protected by high tariffs and quantitative restrictions.

During this period, South Korea was provided with massive foreign aid by the United States and the United Nations which was raised from US$330 million during the 1950-52 period to $1,745 million of US official aid and $120 million UNKRA aid (UN Korea Reconstruction Agency) for the 1953-1960 period. Most of the aid was in the form of grant and implemented under the 4 categories of non-project, project, technical support and PL480 food aid. A large part of Korea's imports (70%) was financed by aid. Over half of the Korean Government expenditures was also covered by aid through 3 categories: compensation for the reduction of money supply (through the counterpart funds); supports for defense activities; and financing of the reconstruction programs.

As a result, Korea enjoyed an average economic growth rate of 4% a year, increased the value-added manufacturing sector, mainly light industries, processed food and textile, from 8% of GNP in 1953 to 14% in 1960, reduced the share of agriculture from 47% GNP in 1953 to 37% in 1960. All of these became the very important bases for

Korea to embark on the following period of 1961-1979 characterized by the Export-Oriented and High Growth Strategy of the Park Administration.

A recent case of the preparation of preconditions for industrialization to be referred here is the case of **Vietnam** whose transformation has been characterized by the three tough transitions which occurred all at one time in a small and weak economy: from a war-torn to a peace-time reconstruction economy, from a centrally-planned to a market economy, and from an agrarian to an industrialized economy. The period of "preparation of the prerequisites for the proceeding period of development" in Vietnam was projected to be carried out in the five-year plan from 1986 to 1990, but in fact until 1996 it was formally recognized that "initial achievements" were made which meant that the socio-economic crisis in Vietnam was over and Vietnam may now start a new stage of industrialization. During the preparation period, four main sets of policies were adopted, including the recovery, stabilization, the development of the multi-sector commodity economy, and the opening of the economy to the outside world.

Implementing the first policy of *recovery* of the economy from the war-torn conditions and the crisis aftermath, three important programs of food production and food processing, consumer goods production, and exports production were launched. The main measures carried out under these programs were the contract system in agriculture, the gradual reduction of subsidies, the expansion of the autonomy of industrial enterprises' (mostly State-own enterprises), and the promotion of exports.

In regards of the *stabilization* policy, numerous measures were adopted such as the control of inflation through the positive interest rate policy, the reduction of money supply, and the "basket" policy of price, wage, and monetary changes. These policies first failed twice in 1981 and again in 1985 due to their "big bang" and hasty manner or due to the poor preparation, but later turned out very good results, particularly since the beginning of the 1990s thanks to the new approach of step-by-step adjustment.

The third major policy relates to the development of a *multi-sector commodity economy* which was understood as the "first step" of advancing toward the *market mechanism,* then the "*socialist-oriented market economy*" adopted in the succeeding period of 10 Years Social-Economic Development Strategy and industrialization of the 1991-2000 period and later on.

The forth set of policies was the *opening of the economy* for trade, foreign investment, and regional and international cooperation. The main measures implemented under this policy was the issue of the Foreign Direct Investment Law in 1987 and the diversification and multilateralization of directions and forms of foreign economic relations. The goal of this policy was to reverse the loss of traditional markets of the former Soviet Union and East European countries, the recapture of the regional market of Asia and the Pacific, the lift of the US economic embargo and the normalization of relation with the United States, and the expansion of Vietnam's international economic relations as a whole.

The implementation of these policies brought Vietnam important achievements such as the overcome of the socio-economic crisis, the survival from Soviet aid cut and US economic embargo and sanction, the relatively high growth rates of 8-9% a year during the first half of the 1990s, the change from food and consumer goods shortage into surplus, particularly from the imports of a million tons of food a year to the exports of 3 million tons of rice a year, the drastic reduction of inflation from around 800% in the mid of the 1980s to 5% in recent years, the transformation of the economic structure oriented toward industrialization with the share of the industrial and service sectors rising from 60% to 75% of GDP while that of agriculture dropped from 40% to 25%, the increase of domestic capital savings from 10 to 25% of GDP, the development to certain degree of the markets for commodity, labor and capital, the improvement of the living conditions of the people with the increase of the GDP per capita from less than US$200 to nearly $400 in ten years, the expansion of trade with exports raised from half a billion US dollars a year in the mid of 1980s to roughly $15 billion by the year 2000 and imports of about $16 billion, the growth of FDI from almost non in the end of 1980s to $3 billion a year by the end of 1990s, the reception of about $2 billion a year of foreign aid, and the remittance of over $3 billion a year by overseas Vietnamese and Vietnamese working abroad. Vietnam's integration into the Southeast Asian and the Asia-Pacific region has been impressively developed with the latter currently makes up of 70-80% of Vietnam's total foreign trade and FDI. Vietnam's normalization with the United States was made in2001. And Vietnam's joining the World Trade Organization (WTO) is likely to be set up by the year 2004 or 2005. These are the positive preconditions for Vietnam to take off, though challenges and difficulties are still numerous.

The above three examples of Japan, South Korea and Vietnam representing the three generations of industrialization in East Asia suggest two points:

First, though the preparations in one country vary from the other, there are certain *common areas* that each country needs to do. Those are: (1) the setting up of both hard and soft infrastructures; (2) the development of various markets for commodity, capital and labor; (3) the building of selected industries; (4) the adjustment of macro-economic policies, particularly the policy of stabilization; and (5) the opening of the economy to the outside world to benefit from the integration and globalisation processes. Another very important issue (Number 6) is the preparation of a healthy, well-educated and skilled human resource. Though the last issue was not discussed above, it was in fact highly developed thanks to the traditional Asian culture and the continuing efforts during the period of preparation. Prior to the industrialisation process in these countries the number of educated people already made up 70-80% of their population out of which a large part was of high business skill level.

Second, the East Asian experiences showed that there has been almost always a period of preparation in each country of Asia before they really embarked on the take-off or industrialization process. This requirement of precondition preparation has become an *objective necessity* for a developing nation to industrialize, without which the nation would probably be impossible to successfully advance to the take-off period or to embark on the path of development to become a Newly Industrialized Country (NIC), because of the very high criteria for a less developing country to become a NIC. In a definition raised by OECD, these criteria are of three-fold: The fast growth in both the absolute level of industrial employment and the share of industrial employment in the total employment of the country; The rising share of manufacturing exports in the total volume of exports of the country; and The fast growth in real GDP per capita in a way such that the country was successful in narrowing the gap with the advanced industrialized countries.

Comparing to the experiences of East Asia, it has been evident that in East Africa changes, especially the reforms and adjustment programs, have often been launched without or with very little preparation. In Tanzania, for instance, when the country shifted from its earlier centrally and administratively economic management system dominated by the public sector to the market economy dominated by the private sector, the State has conducted *fast liberalization and privatization programs without sufficient preparations of the necessary conditions* such as the formulation of a legal environment along with necessary social and economic institutions to match with the process of liberalization and privatization, leading to numerous defects and errors in economic management and performance, making it difficult to manage the speedy changes, hence worsening the socio-economic situation, instead of improving it. The consequence was that many serious social problems were not settled, a

number of areas which were formerly given attention and developed well have deteriorated, particularly the increasing poverty, the downgrading educational system, and the wide-spread diseases, notably malaria and HIV/AIDS.

However, some preconditions have been set up to certain degree in East Africa as a result of various reforms and adjustment programs, such as some market and infrastructural bases which would be useful for the industrialization process. But there is still great need for further development in these and other areas like the development of the human resources and the acquirement of new technologies the results of which would be the determinant factors for the future success or failure in their industrialization cause.

4.2 Factor developments

a. Capital formulation

Capital is the Number 1 factor for the development of industrial production. The two major sources that helped East Asia to quickly mobilize its capital are the high domestic savings and the large inflows of foreign capital through FDI and borrowings. The first was made by the self-help efforts or the good savings habit of the East Asian people, the proper monetary policies of the governments, particularly the low taxes, the positive interest rates and the credibility of the banks which aroused people to save. The second was acquired mainly through the implementation of the foreign investment laws and the rapid capital-market liberalization policy.

Tax is a very important instrument for the Governments in all market economies, its roles however vary depending on the specific needs of the countries that use it. In developed countries where the level of development and the income of a large part of the population are high, the need for social welfare becomes a pressing issue, the high tax policy is supported. However, in most developing countries of East Asia, social welfare is something still far ahead because of their low level of income. The most intermediate concern of the people in these countries is high growth and high savings which are inter-related. The low tax policy is therefore welcome as an important source of high savings and, thus, high growth. In most of the East Asian developing countries corporate taxes often range from 20 to 25 percent while personal income tax rates are from 30 to 40 percent compared to 40-50 percent and over in developed countries. *Table 1* shows the best proofs of the effects of the low personal income tax rates in Asian developing economies compared to the high tax rates in the developed world: fast-growing Asian countries tend to have lower tax rates than industrialized slow-growing Western nations. The logic is lower taxes,

lower social welfare, higher savings, higher growth; higher taxes, higher social welfare, lower savings, lower growth. The choices and priorities lay in the hands of each nation at each stage of its development.

Table 1: Personal taxes in selected Asian and Western countries

Country	Maximum personal tax rate (%)	Level at which maximum rate applies (US$)
Hong Kong	15	051,000
Singapore	30	272,000
Malaysia	32	059,000
Indonesia	35	023,000
Philippines	35	020,000
Thailand	38	160,000
Taiwan	40	128,000
South Korea	48	080,000
Japan	65	206,000
Sri Lanka	35	001,468
Pakistan	40	098,000
India	41	003,200
New Zealand	33	019,000
US	40	250,000
Britain	40	039,000
Australia	50	037,000
France	58	054,000

Note: Estimation from the Chart.
Source: FEER, Nov. 24, 1994, p.48.

Thanks to the proper policies of the Governments and the good savings habit of the people, from the 1950s to the 1990s many of the Asian developing countries were able to raise the share of their savings from 10 to 30-40% or even in some cases 50% of their GDP – the highest level in the world. As it is illustrated in *Table 2* the US and German savings rates are lower than any of the Asian countries selected for comparison.

Table 2: Gross domestic savings as% of GDP - **(selected countries, 2000)**

Country	% of GDP
US	14
Germany	23
Japan	27
Hong Kong	31
South Korea	32
Thailand	33
Malaysia	46
Singapore	49

Note: Estimation from the Chart.
Sources: - ADB, IMF, Recited from FEER, May 25, 2000, p.66. See also Gross domestic savings as percentage of GDP in 20 years (1975 and 1993) of Asian countries (including Hong Kong, Taiwan, South Korea,

Singapore, China, Indonesia, Malaysia, Philippines, Thailand, India, Nepal, Pakistan, Sri Lanka), FEER, Nov. 24, 1994, p.46.

In fact, Asia's high domestic savings has become the largest source of capital mobilization. It has greatly contributed to the high economic growth of many countries in the region, therefore it has been recognized as the largest engine of growth in Asia.

The second large source of capital mobilized in Asia, e.g. foreign direct investments (FDI) and borrowings. In this part we will discuss about foreign borrowings, FDI will be dealt with in a later part. In fact, foreign borrowings did positively contribute to the East Asian economic growth during the initial period of industrialization when there was a real need of this capital in the countries of the region because of the low savings rate at the time. To the second half of the 1990s, the situation had changed, most of the countries were able to raise their domestic savings to a level basically sufficient to their need, so this large source of foreign capital accumulated as a result of the easy access to foreign capital under the rapid capital-market liberalization imposed by outsiders turned out to be over-invested, becoming a bubble and bursted due to its misuse. *Joseph Stiglitz* (2002), the 2001 Nobel Prize winner, called this "East Asia crisis, a disaster for which the US Treasury Department is at least partly to blame." According to *Joseph Stiglitz,* the US "Treasury, in conjunction with the IMF, encourage rapid capital-market "liberalization…", the opening of underdeveloped markets to the onslaught of highly speculative investment, which can move in and out overnight and leave economic devastation in its wake. With the high savings rate in the East Asian countries there was no need of them to open up rapidly; those countries, in other words, had enough domestic capital for productive investment to make the need for an influx of foreign capital less urgent…Indeed, the overwhelming evidence…is that *rapid liberalization is extremely risky for developing countries* [emphasis – Dinh]. Treasury ignored this evidence and pushed for faster liberalization. It won – and the world lost. Having in large part created the East Asia crisis, Treasury and the IMF… "the crisis was largely the result of the overzealous market promoted by Treasury and IMF". No more comment is needed to be made after this deep analysis by *Joseph Stiglitz*.

The true facts experienced by East Asian countries are the really worth lessons for the East African countries, whose savings rates are currently around 10 to 15% of their GDP and who are active on the path of rapid liberalization and privatization, to learn.

b. Technology transfer

Conventional technological change has often been developed through two steps: innovation and diffusion, with the first step of initial development and commercialization of innovations concentrated heavily in industrial countries, and the second extended to developing countries normally when innovations were widely applied throughout the world.

In East Asia a limited level of technology development has been made just recently and concentratedly in a few countries like Japan and Korea where the economic and technological bases and/or infrastructure reached the developed countries' level. Beside that, most of the change in technology has so far been diffused through the transfer and adoption of imported technologies. The diffusion of technologies to developing countries in East Asia has been carried out in two stages: (a) adoption, including incorporation and adaptation of original technologies, and (b) post-adoption in which the original technologies and its initial efficiency were raised and modified to conform the changes in inputs and product markets.

Psychologically, most East Asian developing nations prefer to acquire modern technologies. However, practically they have been aware that it would be very difficult to do so, because firstly the developed countries often keep new technologies for themselves and do not want to transfer them to developing countries until those technologies no longer bring them super-profits, and secondly developing countries do not have sufficient capacities and facilities to adopt those technologies at their initial stage. Developing countries' main choice has therefore usually been the "appropriate" technologies. But the term "appropriate" is vague and confused as it is not clear whether with that kind of technologies developing countries may be able to move forward to advanced technologies, or stay long with and trapped in the old, backward and polluted technologies. The East Asian relatively successful countries like Korea and Malaysia have proved that even though we have to accept the old, backward and polluted technologies sometimes and mostly short time, there is a need of policies to contain those technologies and to encourage the advanced ones.

The vehicles for technology transfer to developing countries vary from time to time. As the East Asian experiences have shown, during the initial stage of industrialization when the local entrepreneurship and the infrastructure, including both hard and soft, was poorly developed, the best way for developing countries to acquire foreign technologies, among other things, is to set up export processing zones (EPZs) and industrial zones (IZs) where better facilities are concentratedly

built, and to attract foreign direct investments (FDI), particularly joint ventures, because these investments often bring new technologies to the countries where they locate. To the later periods when the general infrastructure and the technology adoption capacities of developing countries were better developed throughout the country, other forms of technology transfer may be additionally promoted, including the Build-Operate-Transfer (BOT), the Build-Transfer (BT), the unpackaged modes of transfer (subcontracts…), and the High-tech Parks. International agencies like the UNDP, UNIDO, the sending of local personnel to be trained in developed countries also play important role in the development of new technologies in developing countries. Other forms of technology transfer as the setting up of technological alliances among developing countries or the South-South transfer have been promoted, but so far yielded not high fruits.

In order for developing countries to acquire new technologies the roles of both the Governments and firms are equally important, especially in the evolution of the four continuous stages through (a) the accumulation of skills and know-how in new coming processes; (b) the intensive or deeper accumulation of knowledge, skills and experiences for incremental changes; (c) the improvement of available technologies; and (d) the introduction of new kinds of technologies or innovations.

From the East Asian experiences the success or failure of technological accumulation in developing countries depends largely on the following key factors:

- The ability in acquisition of foreign technologies;
- The investment in education, training and research;
- The economic incentives for innovation and imitation;
- The continuous growth of demand;
- And the institutions and policies designed to encourage firms to technological accumulation.

Should the East African countries meet these conditions, they would be successful in the process of their technology transfer and development which would be one of the most crucial factors for the success of their industrialization.

c. Labor improvement and utilization

East Asian labor has so far been highly respected for its salient features of high investment for education and hard work. The share of around 90% of their population having been educated proves the outstanding job they have done to improve the knowledge and know-how of their people in comparison to the related

developments in Africa and Latin America. However, they are still in a very much lower position compared to the very well and highly educated and skilled labor in developed nations. In a world of globalization where developing nations have lower comparative advantage concerning their lower level of educated and skilled labor, working hard is one way for them to fill the gap between themselves and the developed nations. *Table 3* explains how much the difference between the working hours per year and the paid holidays of the workers in selected cities of Asia and Europe and how much that the Asians work harder and enjoyed less than their developed counterparts. This work ethic is a very important element in the high economic growth and the fast industrialization of Asian countries.

Table 3: Annual work hours and paid holidays of selected Asian and European cities

City	**Working hours per year**	**Paid holidays**
Asia:		
Seoul	2,302	7.8
Bangkok	2,272	8.8
Hong Kong	2,222	12.1
Taipei	2,136	17.o
Singapore	2,044	17.7
Europe:		
Copenhagen	1,669	25.0
Dusseldorf	1,682	30.5
Madrid	1,721	32.1
Frankfurt	1,725	31.2
London	1,880	22.1

Note: Estimation from the Chart.
Source: FEER, Nov. 24, 1994.

As the industrialization process moves on, the migration of labor from rural areas to the cities increases and the mobilization of labor force for industrial production expands, the main concerns of labor-market policies have been the protection of the low income groups (particularly the minimum wage setting), the security of workers' jobs (job security), and the guarantee of the living conditions of the people (social security). The main aims of labor-market policies are therefore to raise the welfare of the people, to reduce exploitation and to improve labor quality and productivity.

Though these objectives have been commonly agreed upon, there has been wide disagreement about the value of institutional interventions in developing countries'

labor markets. The World Bank's argument is, for instance, that intervention measures such as wage regulations, mandated contributions to social funds, job security and collective bargaining, are the "distortions" in an otherwise ideal world (and because of this they were identified as "distortionists"). According to this viewpoint, interventions are major impediments to the resources allocation, structural adjustments and stabilization programs, which result in sizable costs for economic and social development.

The ILO "institutionists" on the other hand protected the "benefits of interventions" as they saw regulated markets adjust better than unregulated markets to shocks. They proposed the tripartite (unions, businesses, governments) consultations and collective bargaining.

East Asian experiences have suggested a more empirical than theoretical perspective: regulation or not depends largely on the specific requirements of the economic and social developments, rather than on theory. That is the reason why most East Asian countries at the initial stage of their industrialization adopted the minimum wage regulations, and not the mandated contributions to social funds. In the case of South Korea, for example, the tripartite consultations never appeared on the agenda of their labor market policies until the 1997-98 financial crisis when lay-off of workers was allowed, leading to serious labor disputes, because prior to the crisis workers' jobs were secured, so there was no need of such consultations.

Richard B. Freeman (1992) was right when he stressed the need for study of specific interventions and institutions before generalizations.

4.3 Growth or Development?

This question is raised because of the wide range of changes and imbalances often accompanied the process of industrialisation, including the transformation of the economic structure, the differentiation of social strata, the widening gap of the urban and rural areas, the degradation of the environment, and others. The answer to this question helps defining the pattern of industrialisation, thus the solutions to the imbalances and changes that industrialisation brings about.

If industrialization followed the growth pattern set by conventional economic theorists it naturally follows what is often identified as the "pyramid growth" or the "trickle-down" theory which concentrates on *economic growth* or "figures count" meaning mainly the GDP growth rates or GDP per capita income, neglecting the

social dimensions. If it followed the socialist pattern basing on the principle of social equality it certainly puts high emphasis on the redistribution of income rather than on economic growth, hence industrialization without growth. In most of East Asian developing economies these two extremes have merged during the process of *socio-economic development*, in which economic growth complements social changes and vice versa. In other words, growth has been made not just for growth itself whose single largest and ultimate aim is maximum profit, but also to improve the social benefits, to reduce poverty, to increase the living standards, to ensure health care, to develop education, to enhance the quality of life, and in turn social benefits have become motivations for further growth. By the 1990s, a new concept of *sustainable development* was developed to cover also the protection of the environment which has been damaged by industrialization. In accordance with this new trend of development, East Asian countries have recently given higher attention to the protection of the environment.

As industrialization goes on the pattern of socio-economic development has been increasingly recognized and concretized into specific criteria such as the *Human Development Index* (HDI), for instance, to be used as tools for the evaluation of the actual development in a country or a group of countries.[2]

Though the trend of socio-economic development has been increasingly developed and recognized, it has not been equally understood and adopted by every country or organization. In the socialist-oriented countries, for example, the social dimensions have been highly addressed, whereas in the non-socialist-oriented ones higher economic growth has been their favor, even both kinds of countries have formally stated to follow the market economy or being in transition toward the market economy.

The same situation has also taken place in international organizations. UNDP seems to have been the one most favored of the pattern of socio-economic development. The World Bank has changed its focus from mainly economic growth to social-economic development.[3] The IMF on the other hand continues to stick to the market

[2] The Human Development Index (HDI) includes 3 essential components of human life such as Longevity (life expectancy), Literacy (educational attainment) and Real income per capita, (See UNDP, *Human Development Report,* 1995, New York, Oxford University Press, Chapter 1).

[3] The WB Development Report, 1990, addressed 3 crucial areas of development, including economic growth, human capital development, and the social safety-nets.

economic principles, paying little concern to social matters, and is skeptical about equity.[4]

[4] One IMF publication questioned: "*Should Equity Be a Goal of Economic Policy?"* IMF Fiscal Affairs Department, 1998, Economic Issues No. 16.

Adopting the pattern of socio-economic development, East Asia countries have managed to maintain a high average annual growth rate of 8-9% throughout a long period of half a century since the 1960s while having been able to reduce the difference in income between the top and the bottom 20% of population from over 20 times to 4-5 times during the same period. This is really a big achievement compared to Latin American and East African countries where the gap between the two groups still remain as much as 30-40 times, and being the same as it was four decades ago. The typical examples of this development in East Asia are Japan, South Korea and Taiwan.

The increase of income and the improvement of the living conditions in East Asian countries have greatly contributed to the improvement of their quality of life, particularly the extension of their life expectancy – the most general indicator of the quality of life. As it is shown in *Table 4* life expectancy has been risen in all Asian countries, particularly in Japan and Hong Kong where life expectancy is already higher than the levels in Western countries like the United States, Britain and Germany.

Table 4: Life expectancy in Asia

Country	**1977**	**1992**
Japan	74*	79
Hong Kong	72	78
Singapore	71	75
Taiwan	71	75**
South Korea	65	71
Malaysia	65	71
Thailand	61	69
China	65	69
Philippines	60	65
Indonesia	52	60
Sri Lanka	66	71
India	53	61
Pakistan Bangladesh	52 47	59 55
US	73	77
Britain	72	76
Germany	71	76

*1975.

**1993.

Note: Estimation from the chart.

Source: FEER, Nov. 24, 1994, p.49.

In East Africa it seems there has been so far no differentiation between growth and development. The fact is that after 40 years since independence the average life expectancy of the countries of this region has not grown, but constantly declined from over to under 50 years, while their GDP per capita increased very marginally from around US$100 during the 1960s to just $190.5 (1995 price) in Tanzania, $328.2 in Kenya, and $348.0 in Uganda in the year 2000, yet the economic growth rate is not high, 5.1 percent in Tanzania, –0.2 percent in Kenya and 3.5 percent in Uganda in the year 2000, and the share of the people living under poverty line makes up about half of their population (*Some of these figures are available in Table 5*).

Table 5: East African Countries' Selected Indicators, 2000

	Tanzania	**Kenya**	**Uganda**
Population (Million)	33.7	30.1	22.2
Labor Force (Million)	17.3	15.5	10.9
GDP at current prices (Mill $)	9027.5	10357.0	6170.2
GDP at 1995 prices (Mill $)	6418.6	9876.1	7728.0
GDP per capita (1995 prices $)	190.5	328.2	348.0
GDP growth rate (annual)	5.1	-0.2	3.5
Structure of the Economy (per cent)			
Agriculture/GDP	45.1	19.9	42.5
Industry/GDP	15.8	18.7	19.1
Manufacturing/GDP	7.5	13.1	9.1
Services/GDP	39.1	61.3	38.4
Trade/GDP	37.9	62.1	35.9
Foreign Direct Investment Inflows/GDP	2.1	1.1	3.6
Exports of goods and services/GDP	14.7	26.5	10.1
Imports of goods and services/GDP	14.7	26.5	10.1

Source: - World Development Indicators, 2002 – CD ROM
- George Kabelwa: South African FDI into East Africa: The case of Tanzania, ESRF Globalisation and East Africa Project, Dar es Salaam, 2002, p. 23.

4.4 Poverty Alleviation

In the process of their socio-economic development, developing countries have faced many tough problems and challenges among which poverty is one of their top concerns. Currently countries with GDP per capita income of US$1000 or higher are considered semi-developed or developed which have basically solved the problem of poverty, otherwise they are under- or least-developed if their GDP per capita is bellow US$500. In these under- and/or least-developed countries the people who live under the poverty line often obtain very low earnings which are not sufficient to assure their basic needs including food, clothing, fuel, clean water, electricity and education.

The main causes of this poverty are the poor economic and social development resulting from the low economic growth rates and the unequal distribution of income, the stagnation of productivity, unemployment, illiteracy, high levels of fertility and the degradation of the environment. The improper policies of the Governments which lead to what being called “social exclusion” are also listed among the causes of poverty. In these cases the poor are often excluded from the normal social life, e.g. from job, land, education, housing, health care, clean water, electricity and good environment.

In face of those problems, it is not easy for developing countries to reverse their development trends from an under-developed to a developed country overnight, it is therefore necessary for them to sort to the most effective policies for poverty alleviation. As experiences in East Asian countries have shown, the most important actions for poverty alleviation at the initial stage of their industrialisation are the creation of jobs and the development of education and health care. These have often been done through the building of labor-intensive and export-oriented industries, the development of agriculture and the processing of agricultural products, the development of consumer goods and services, and the raising of investment for education and health care. The large unemployment is often seen as a big burden for developing countries, but when it is used for the development labor-intensive and export-oriented industries, its low costs turn to be the advantage for these poor countries to produce low price and competitive products. As for education and health care, some developing countries when transforming to the market economy simply assumed that education and health care would also be based on the market principles, and because of that they reduced the investment for these two sectors, the result was that both education and health care worsened, leading to the loss and the lack of skilled and healthy human resources for development. It is true that investments for education and health care often raise high costs and yield low short-term returns, but because of its dominant and long-term role in development, it should be given high priority, and the Governments should set up policies to mobilise all sources of contribution for the development of this cause, including the private sector, the mass and social organisations, and of course the Government as the main contributor.

The second important set of policies for poverty alleviation is the support for the self-help efforts of the poor themselves such as the provision of micro-credits, the training of job, and the group, team or collective cooperation. These policies are necessary because, as surveys in a number of developing countries have shown,

many of the poor people have the capacity to develop, but they lack capital, skill and cooperative efforts. Supporting these efforts means supporting the long-term self-advancement of the poor people, helping them to upgrade themselves from the list of the poor to the middle group in which they will start their own business and no longer queue for "charity" assistance that the society has to bear. Otherwise, they will continue to remain in the list of the poor waiting for assistance.

Beside the above policies, measures like the provision of food and other necessary consumer goods as subsidies or charity are also important, because it helps the poor to save themselves from the time of their most urgent needs, but the effectiveness of those measures are only of the short-run manner. So those measures should be put at the lowest in the list of priorities for poverty alleviation.

With their high commitments and continuous efforts for poverty alleviation, many East Asian countries have been, as seen in *Table 6*, able to reduce to a large extent the levels of their poverty in one to two decades. This achievement in East Asia shows a great different picture compared to that of East Africa where the poverty problem continues to remain as serious as forty years ago, a consequence of the low level of investment for the self-help efforts of the people such as job creation, education development, health care, work training and micro-credits provision, though large amount of kind and cash valued billions of US dollars were provided through the very sound so-called *strategies* and *programs* of poverty alleviation under which numerous generous donors' money were given out mostly as charity.

Table 6: Changes in percentage of population below poverty line in Asia

Country	Year: Percentage	Year: Percentage
Indonesia	1972: 58	1982: 18
Malaysia	1973: 38	1987: 15
Singapore	1972: 31	1982: 10
Thailand	1962: 59	1986: 26
India	1972: 54	1983: 42
Pakistan	1962: 54	1984: 23
Sri Lanka	1963: 38	1982: 28

Note: Estimation from the Chart.
Source: FEER, Nov. 24, 1994, p.46.

4.5 Foreign Economic Policies

a. Trade, investment and aid

In East Asia, trade, investment and domestic savings have been recognised as *engines of growth*, not aid. ODA is, though important, just an assistance in itself. Many East Asian DEs got large aid during the 1950s and 1960s, such as South Korea, Taiwan, Thailand, Indonesia, Vietnam (both North and South), among the others, but did not grow well in those years. Only when their foreign trade, investment and domestic savings grew, greatly bypassing aid, their economies grew. Aid dependency in the case of South Vietnam from the 1950s to the mid-1970s was a disaster: it boosted bureaucracy, discouraged business, destroyed traditional industries while did not help developing the new ones, it damaged agriculture, turning the country from a large food surplus producer and food exporter in Indochina during the 1930s-1940s into a country of serious food shortage and a large food importer in the 1960s-1970s. The South Vietnamese economy became a negative-growth-aid-dependency economy during the whole period of 25 years under the US rule. East Africa today looks somewhat similar to East Asia decades ago concerning these matters. Re-orientation of the development of trade, investment, domestic savings and aid, and recapture of their proper role in growth and development is very much in need for East Africa now and on.

There have been to date some proposals for change in East Africa, for instance the recommendation of an *"aid exit"* strategy, the call for promotion of trade, investment and domestic savings. These calls have, however, not yet institutionalised, so fruits have not yet been harvested. The proper term concerning aid should be an *"aid dependency exit" strategy*, rather than "aid exit", meaning not necessarily to cut aid, instead to re-orient the utilisation of aid as a supplement source for growth and development. In accordance with this, aid priorities should be redirected from their present political-social-environmental bias (democracy, charity, poverty, gender, environment) to *economic growth first* to meet the current most important needs, rather than the other way around. Hence, using *ODA as incentives to promote exports, investments and savings*, limiting imports, particularly those commodities being or to be able to be produced internally. Without doing this, the economy will be poorly performed, resulting in low growth and failure to pay debts, thus aid dependency, low growth and debt crisis are likely to be a vicious circle without escape. The philosophy behind this is: relying on aid to reducing aid dependency.

In East Asia, Japan and South Korea had been the typical cases of utilising foreign aid for the purpose of economic growth at the initial stage of their industrialisation,

and as a heritage from their past, today when they have become aid providers, they usually use their aid for the purpose of economic growth first.

Vietnam is to be referred here as one of the latest cases in East Asia that has been able to reorient her economy from an *aid dependency* toward a *trade- and investment-driven growth* in which trade and investment have become actual engines of growth. It is still recalled today in Vietnam that during the long period of the US domination in the South from the 1950s to the mid-1970s, plus 20-years of the US aftermath embargo up to the first half of the 1990s (four decades and a half all together), the Vietnamese economy, including both parts North and South, was nearly totally dependent on foreign aid, either from the former Soviet Union or the US. But since the beginning of the 1990s up to the present time, new efforts of renovation and opening policies have raised the value of exports and FDI to over 7 times larger than that of aid (US$16.7 billions of exports and FDI compared to $2.3 billions of ODA). Aid is now about 5% to 6% of Vietnam's total GDP, or $2.3 billion of aid over $40 billion GDP in 2001. Though aid is still a challenge for Vietnam today since it relates much to the "debt trap" that one day Vietnam may fall in, one thing possible to identify is that the economy is no longer defined as an aid-dependency one.

The above developments in Japan, Korea and Vietnam show a big difference compared to East African countries where aid has normally made up 15% of their GDP, or specifically 14.3% of Tanzania's GDP (S.M. Wangwe, Brian Van Arkadie, 2000, p.102), almost equal to their exports and about 5 to 7 times larger than their foreign direct investments.

Following figures will further illustrate the picture: Tanzania exported $937 million in 2000 and received $963 million of aid in 1997; the respective figures for Uganda were $500 million (1999) and $1,400 million (2000); and Kenya: $1,7000 (2000) and $457 million (1997), Kenya looked better. Foreign direct investments in these countries are very marginal, 2.1 of Tanzania's, 1.1% of Kenya's, and 3.6% of Uganda's GDP in the year 2000. Export percentages compared to GDP are 14.7%, 26.5% and 10.1% for the three countries respectively (*Table 5*). Domestic savings rates are around 10% to 15% of their GDP.

For East Africa, better infrastructure and environment for FDI and higher incentives for exports and savings are needed, EPZs and IZs should be set up to avoid infrastructure constraints, the large gaps between deposit rates (4-5%) and credit rates (20-22%) should be narrowed to encourage investments, a positive interest rate

regime should be adopted to boost savings, money supply and aid counterpart funds should be reduced to push up Government efforts, and so on.

b. Regional integration

In East Asia a number of regional organizations has been set up: the Asia-Pacific Economic Community (APEC), The Association of Southeast Asian Nations (ASEAN), the Mekong Committee, and others. Among these ASEAN has been seen as one of the most successful and typical cases of DCs' regional cooperation, not only because of its long time existence, since 1967, and its expansion of membership from 5 to 10, but mostly because of its proper way of integration. The achievements of ASEAN's integration have thus far not much been large in quantity (e.g. it tackles only about 2% of its total trade value), but it has been able to maintain regional stability for development, to proceed with the unity in diversity, to formulate a common stance (e.g. ZOPFAN – Zone Of Peace, Freedom And Neutrality) and principles to solve disputes and to avoid splits (e.g. consensus); to carry on a broad range of regional cooperation programs and projects in almost all areas of development from political to economic, social and technological issues. In the field of economic development, for instance, cooperation has been developed in trade (PTA - Preferential Trade Arrangement), industry (AIPs – ASEAN Industrial Projects, AICs – ASEAN Industrial Complementarities, AIJVs – ASEAN Industrial Joint Ventures), agriculture, basic commodities, finance and banking, transport and communication, coordination in external economic relations or regional "collective diplomacy", and most recently in the establishment of AFTA – the ASEAN Free Trade Area and the preparation of conditions for the operation of AIA - the ASEAN Investment Area.

Concerning AFTA, various approaches have been identified to solve difficult problems such as the different lists of the Common Effective Preferential Tariffs (CEPT) Scheme including 1-the Inclusion List (IL) which covers most low tax and easy-to-be applied items, 2-the Temporary Exclusion List (TEL) which makes up mainly of items that may negatively hit members countries' industries in certain periods of time, 3-the General Exception List (GEL) which includes harmful items such as narcotics, explosives, military equipment, cultural products harmful to education and social security, exotic chemicals and pharmaceuticals, and wastes; and 4-the Sensitive Exception List (SEL), including non-processed agricultural products as meat, eggs, rice, alive animals.

AFTA aims to expand the ASEAN market, to attract FDI, to facilitate production and to promote competition and complementation. AFTA which covers a group of 10

countries of 500 million people with a purchasing power of $1,300 billion, trade value of $720 billion, a GDP of $737 billion would create greater opportunities for member countries than separate nation can do. After nearly 10 years of AFTA implementation, a number of products of member countries have been found more competitive such as in the case of the 5 products of Vietnam, including rice, coffee, marine products, rubber, and textile and garments.
However, AFTA has also faced not a few challenges such as the hard competition that led member countries to adjust some of their committed lists of items like Malaysia adjusted automobile parts; Indonesia raised petrochemical tariffs and seven other products from 5% to 25%, 30%, 40% 1997, and promised to lower them to 5% in 2003 when AFTA is to be effective, due to inappropriate taxes in previous years; or Vietnam found negative impacts (deficits) on some of their products that led to the 1997 temporary ban of nine types of goods, including construction steel, paper, cement, glass, beer, soft drink, motorbike, and passenger car with less than twelve seats, which were complained by the Malaysian companies that the decision made them lose about US$248 million from contracts signed with Vietnamese counterparts.

Other problems are the competition for foreign capital and the unequal levels of development of member countries, particularly the differences between the two groups of ASEAN-6 (Brunei, Singapore, Malaysia, Thailand, the Philippines and Indonesia), which has entered 2nd stage of industrialization, and ASEAN-4 (Cambodia, Laos, Myanmar, Vietnam), which is still at its initial stage of industrialization. This situation suggests the approach of competition along with complementation.

East Africa has a long history of regional cooperation which dated back to 1922 when Tanganyika joined Kenya, Uganda and Zanzibar to form the first East African initiative for common services, and since then several regional bodies were set up like the East African High Commission (1947-1961), the East African Common Services Organisation (1961-1967), and the East African Community (1967-1977) which ceased to exist due to historical reasons. On 30th November 1999 the Heads of State of the three East African countries, Kenya, Tanzania, Uganda, signed the Treaty for the re-establishment of the East African Community which was ratified and entered into force on July 7th 2000. The new EAC aims to remove existing tariffs and non-tariff barriers, to re-establish formal economic ties geared toward a single market and investment area, to turn East Africa to be an attractive investment area, to harmonise members' policies, to build a region of free trade, to issue common

passports, to set up a joint secretariat for railways, to adopt standardisation, to establish an East African Cooperation Assembly and Court of Justice, to focus on long term development of regional economic infrastructure, to develop the private sector to be the dominant sector, to maintain law and order, to facilitate economic reforms, to revoke export duties, to remove restrictions on repatriation of profits, to abolish foreign exchange controls, to allow market forces to determine the exchange rates, to choose the shilling as the main regional currency with exchange rates vary from country to country, to lower corporate tax, to remove duties on imports of capital goods and raw materials, to implement a 10-year tax holiday in EPZs, to lift shareholding limitations except in few areas.

In general, this is a very large and ambitious agenda of common practices while great differences remain. The question is whether these plans have ever been calculated or just intentions? If they were intentions, concretisation is now needed.

The form of cooperation that the East Africa Community aims to at this stage seems high, developing in three phases starting from (1) a Custom Union, then (2) a Common Market, and (3) a Monetary Union and ultimately a Political Federation of East African States.

In the world today five main forms of regional economic cooperation in accordance of five main successive stages or levels of regional integration have been identified *(Mary Jo Nicholson, Legal Aspects of International Business, p.67):*

- (i) The Preferential Tariff Arrangement (PTA);
- (ii) The Free Trade Area (FTA);
- (iii) The Custom Union (CU);
- (iv) The Common Market (CM); and
- (v) The Economic and Monetary Union (EMU).

So far the European Union (EU) has been the only one that reached the last and the highest stage of the five forms of integration. The ASEAN had passed the first stage and starts to move to the second stage of Free Trade Area (FTA).

The proper form for East Africa at this stage may be the first and the second forms of the above five combined, through the step-by-step approach of formulating common stance and principles, solving disputes and avoiding splits, removing tariff and non-tariff barriers, setting up various economic programs, aiming toward a Free Trade Area and an Investment Area. And even if these lower forms of regional cooperation

were to be the choice, there is still a lot for EAC to do, since there are so many problems and challenges such as the constraints resulting from the low levels of development of member countries, the hard work to replace individual tariffs by a common duty regime as Uganda tariffs are among lowest in region (7% for raw materials, 0-rated for capital goods), attracting more foreign investments than Tanzania and Uganda; the unequal developments of member countries (Tanzanian manufacturing and commercial farming is far behind that of Kenya and Uganda); the "unequal sharing of costs and benefits" resulting from the large intra-region trade gap which is dominated by Kenya (during 1996-1999, Kenya exported to Uganda and Tanzania $1.7 billion, while imported only $49 million); trade imbalance is 20:1 in favour of Kenya to Uganda; Tanzanian export earnings were down more than 1/3, it would be further hit if simplified tax and market regulations to be applied; not yet to mention of other problems like the high power costs, the insecurity concerns, the political differences, some of these were already critical factors behind the split-up of EAC in 1977, and the possible negative impacts of EAC general common tariffs on the unequal developments of member countries' industries, including the currently available and the to-be-built new ones.

In face of these problems, the starting of EAC as a Custom Union (CU) – the third stage of the above five - seems rather high. The economic parameters set forth by *EAC Secretariat* for its 2001-2005 development period including the real GDP growth rate of at least 7%, the inflation rate of less than 5%, the reduction of fiscal deficit to less than 5%, the maintaining of reserves at least 6 months equivalent of normal imports, the scaling-up of the ratio of domestic savings to GDP of at least 20%, and the reduction of external debt obligations to less than 15% of GDP also seem high and ambitious (*The East African Community Development Strategy 2001-2005, EAC Secretariat, Arusha, 2001, p. 23*).

5.0 FINANCIAL CRISIS AND REASSESSMENT OF EAST ASIAN MODEL

5.1 The Crisis

The Asian financial crisis occurred in 1997-98 was the largest setback in the history of East Asian development since the 1950s. It challenged the Asian model and raised numerous issues and implications for Asian economic security and future development.

The crisis started in July 1997 with the Thai Government's decision to float the Baht after decades length pegging to the US dollars resulting in the accumulated unmatched exchange rates between the two currencies. The floating of the Baht then quickly spilled over to other nations in Asia and other regions. The five most affected economies were Indonesia, South Korea, Malaysia, the Philippines and Thailand. In these countries large capital outflows run overnight, the exchange rates tumbled, the local currencies devaluated fast, domestic financial institutions, particularly the banking system was seriously damaged, financial intermediation stagnated, industrial capacities were under-utilized, serious underemployment emerged and expanded rapidly, effective demand drastically reduced, economic growth rates sharply dropped. Statistics recorded that in 1997 the outflows of capital from Asia was $30 billions. Also in 1997 Indonesia devaluated her currency 80%, South Korea 60%, Malaysia, Philippines and Thailand 40%, Singapore and Taiwan 20%. In 1998 the growth rates of Thailand was –4%, Indonesia –5.2%, South Korea –6.7%. Wages dropped sharply, in January 1998 for instance, monthly earnings were $1,350 in Singapore, $1,150 in Hong Kong, $1,100 in Taiwan, $840 in South Korea, $300 in Malaysia, $100 in Thailand, $70 in the Philippines, $50 in China, and $20 in Indonesia (Economist March 7, 1998). The costs of restructuring and recapitalisation amounted to 20-50% of the pre-crisis GDP in worst-affected economies. All these together led to the people's hardship, loss of confidence, and quick changes of Governments in Thailand, South Korea and Indonesia.

The crisis revealed serious hidden problems accumulated as results of the previous policies such as the huge short-term private debts, the large current account deficits and the large capital inflows hoarding from the quick capital-market liberalization. Foreign bank debt as % of GDP in June 1997 reached 45% in Thailand (out of which 30% was short-term debts), the relevant figures for Indonesia were 38% (21%), Malaysia 30% (19%), South Korea 25% (18%), Philippines 22% (15%), Taiwan 10% (9%), China 8% (4%). Short term debts as % of foreign exchange reserves in June 1997

for South Korea were 350%, Indonesia 190%, Thailand 180%, Philippines 100%, Malaysia 90%, Taiwan 30%, China 20% (Economist March 7, 1998). Current account deficits as % of GDP in 1996 were: Thailand –8%, Malaysia –6%, South Korea –5%, Philippines –4%, Indonesia –3.5%, China +1%, Hong Kong 2%, Taiwan 4%, Singapore 15% (Economist March 7, 1998). US$73 billions of capital inflow to the five most affected nations in 1996 stopped and was replaced by an outflow of $30 billions in 1997.

The main cause of the crisis was evident: the rapid capital-market liberalization that led to the imbalance of capital supply and demand. During the 1991-96 period capital inflows were more than double from US$39.5 billion to $94.1 billion as a result of the financial liberalization in previous years, with the greatest increasing in Indonesia (165%) and Korea (267%). Most of the inflows was under the forms of portfolio investment and bank lending, and almost all by private borrowings which were invested in less productive sectors like real estate speculation, resulting in large non-performing loans, high foreign debts, declining reserves, weak financial systems. As the bubble investments swelled without sufficient earnings to pay debts, bank lending started to fall from an inflow of $41 billion 1996 to an outflow of $32 billion 1997. This great capital flight turned the circle around from higher supply (inflows) over demand (outflows), which coincided with a "healthy growth" to a situation where demand overloaded supply, thus crisis.

Three years after the crisis broke out these and other factors were addressed by *Joseph Stiglitz* (2000) as follows:

- The flood of short-term capital of highest and fastest returns, as opposed to long-term investment in things like factories;
- The fueling an unsustainable real estate boom, or bubble economies which eventually bursted;
- The quick and at-the-same-time in-and-out-flow of capital;
- The imprudent private sector including bankers and borrowers who gambled on the real estate bubble;
- The ignorance or the non-concern of bankruptcy and default: center of the East Asian crisis.

There was another factor which was almost not available in the literatures concerning the Asian financial crisis, that was the business cycle downturn. Since the 1950s to 1997 the year when the Asian financial crisis broke out, there were already 71 crises listed as monetary, financial and related crises throughout the world. In

Asia at least *3 crises or glooming periods* were witnessed since the 1950s when developing countries in the region started their industrialization: The first was the oil shock occurred in 1973-74 linked to the tripled world price of oil; the second was the debt crisis of 1980-81 mostly connected to large government debts; and the third was the 1997-98 financial crisis mainly as a result of the accumulated private debts. Crises often occurred one after the other in about 10 to 15 years.

Take the South Korean case as an example, *Table 7* pointed out that in nearly ten years from 1972 to 1999 South Korea had twice fell into business cycle crisis or downturn, in 1980 and 1998 when their GDP growth rates dropped to –2.1% and -6.7% respectively.

Table 7: Korea's business cycles

Year	1. Agriculture	2. Industry	3. Service	1, 2, 3 Average Rate	GDP Growth
1972	3.2	14.3	6.8	8.1	4.9
1973	6.9	29.3	13.1	16.5	12.3
1974	6.2	16.6	6.5	9.8	7.4
1975	4.3	12.9	6.6	7.9	6.5
1976	9.6	23.1	12.2	15.0	11.2
1977	2.6	14.4	11	9.3	10.0
1978	-10.5	20.8	10	6.8	9.0
1979	11	9.5	6.6	9.0	7.1
1980	-20	-0.9	2.2	-6.2	-2.1
1981	17.8	9.5	5.6	11.0	6.5
1982	5.7	5.7	8.8	6.7	7.2
1983	6.6	14.4	10.2	10.4	10.7
1984	-1.6	16.3	10.1	8.3	8.2
1985	4.8	6	9.3	6.7	6.5
1986	5.2	18.7	12.1	12.0	11.0
1987	-4.6	18.3	13.1	8.9	11.0
1988	8.5	12.1	12.1	10.9	10.5
1989	-0.5	3.5	7.9	3.6	6.1
1990	-5.9	9.2	9.3	4.2	9.0
1991	2.9	9.5	10.3	7.6	9.2
1992	9.6	5.3	7	7.3	5.4
1993	-4.5	5.4	7.2	2.7	5.5
1994	0.2	10.8	10.3	7.1	8.3
1995	6.6	11.3	9.6	9.2	8.9
1996	3.3	6.8	7.8	6.0	6.8
1997	4.6	6.6	5.4	5.5	5.0
1998	-6.6	-7.4	-7.2	-7.1	-6.7
1999	4.7	21.8	11.7	12.7	10.7

Source: Bank of Korea and Statistics Korea, yearly.

The nature of the crises vary from one to the other, they may be sectoral crises like the ones broke out in the most vulnerable and bubble sectors such as oil, finance and banking and real estate, or the crises of bias which often happened in the following cases: bias on internal factors (inward-looking or extreme self-reliance) which confined the concerned countries, hence excluded them from growth; bias on external factors such as the high "dependency" on the outside world, thus vulnerable to outside competition; bias on Government intervention where the Governments were free to borrow, hence crisis of Government debts; bias on market-oriented policies, especially the capital-market liberalization and privatization in which private banks and firms were free to get loans, thus crisis of private debts. Though these crises broke out in different ways and under different forms, they may be all treated as certain forms of business cycle crises, and since they often occurred once in about ten to fifteen years, they called for major periodical adjustments of development policies in around the same periods of time to help conform the policies with market changes.

The Asian financial crisis in deed hit every country in Asia and even some in other regions. But not every country was hit with the same pain, since demand and supply of nations are not the same, and not all nations adopted the capital-market liberalization with the same degree. Indonesia, South Korea, Malaysia, the Philippines and Thailand were the five most hard hit, but Malaysia was able to keep the economy stable, less affected by the negative effects of the crisis and faster relieved thanks to the tight currency control measures and the restrictions of short-term international capital movements, South Korea quickly returned to her high growth track as a result of the strong banking, chaboel and labor-market reforms, while Indonesia, the Philippines and Thailand were supposed to do better by following the IMF's universal medicine of fiscal austerity (balanced budgets) and tighter monetary policies, without social mercy, as a precondition to receive aid, they were in fact slower recovered or even fell into chaos as it occurred in Indonesia, the latters' pain happened to be sharp and long, not sharp and short as it was first supposed. In the mean time, China and Vietnam continued to maintain a growth rate of 7% and 5% a year, respectively, during the crisis period, as they continued to keep a positive balance of capital supply and demand and managed to retain tight control on capital account transactions. Malaysia, China and Vietnam proved to be "correct" (Andrew Elek, 1999, p.18). Short-term international capital movements should not be liberalized, though the controls should not be kept long and/or permanent. IMF's "the same medicine for each ailing nation" formula and the big bang approach should not be applied everywhere, otherwise some nations may reap

"too much shock, too little therapy" as it happened in the case of Russia (Stiglitz, 2000).

These facts suggest:

- Common and specific solutions are both needed depending on the concrete situation of the country, not on the generalizations;
- Adequate controls and institutions building, or stabilization, are necessary to moderate the negative effects of the liberalization process rather than one-way approach;
- External supports, e.g. calls for liberalization and privatization, should comply with the recipient countries' social and economic conditions, rather than basing on the donors' assumptions, or on pure economic principles;
- Adequate information and early warning of market developments needs to be set up.

5.2 Reassessment of the East Asian Model

To most Asians and many non-Asian observers and analysts, the Asian financial crisis was a big event in modern economic development, so many of them took this crisis as an occasion to reassess the Asian model to see whether it will continue to be a miraculous model or, if not, what would be the alternative for their future secured and sustainable development.

Less than a year after the break-out of the Asian financial crisis the *Economist* (March 7, 1998) judged that the Asia's six "secrets" of success have now turned to be "deadly sins" of failure: 1- The *high savings* of over 35% of GDP, as much as twice of the US and Latin American level, was no longer their strength, it became the *sign of their weakness,* since much of the money was wasted as subsidies, over-investment, inadequate returns and massive over-capacity; 2- The *small government* with low taxes and spendings of less than 20% of GDP ushered high intervention, subsidies, tax breaks, protected monopolies and maintained underground economies which made up from 30% to 50% of GDP in Indonesia, the Philippines and Thailand; and from 20% to 30% of GDP in South Korea, Malaysia, Taiwan; 3- The *flexibility* once helped the workers and firms quickly adjusted to changes in supply and demand, later became serious *rigidities* in labor and capital markets, turning trade union movements into anger, and structural rigidities; 4- The *good governance* looked good only when the economies boomed, in reality institutions did not keep pace with economic growth, there was a lack of reliable legal regulations, inadequate bank regulations and supervision, lack of corporate transparency, widespread corruption

which would probably add up to 30% to the cost of the business deal; 5- The *long-term relationship between governments, banks and firms* encouraged cronyism and corruption, fake collateral, high return and large and easy businesses for close friends; and 6- *Education* was developed, creating a well educated and skilled labor, but mainly in Hong Kong, Singapore, South Korea and Taiwan, not much in Indonesia, Malaysia, Thailand where serious shortage of skilled workers has become evident in recent years.

Though these "deadly sins" were somewhat exaggerated and could not be used as facts to do away with the real value of the "secrets" of Asian success, they were to some extent true as they reflected the other side of the market-economy coin and would be treated as signs of defects or loopholes in the Asian model which called for correction.

The Asian 1997-98 crisis was defined as the financial crisis, it revealed however not just financial matters, but also many other social and economic problems, challenges and concerns, because it was the result of a long series of accumulated hidden problems which remained in place till the ripe time to expose. That was why since the time the crisis broke out a wide range of problems has been raised including the bubble economies, the social-related matters like the growth without equity, the increasing poverty, the widening gap between the rich and the poor, the expanded unemployment and underemployment, the unsecured labor conditions, the regional imbalances, the excessive bias either on Government intervention or market force influence, on internal or external dependency, the business cycle down-turns, the oil shock, the food insecurity, the labor insecurity, the economic insecurity, the unmanagable capital-market liberalization and privatization, the environment pollution and damage, the globalization that challenges the Nation-State, and other problems.

To date though not all problems have been solved and not all questions answered, certain perspectives have been developed in Asia as such that export-orientation in combination with timely import-substitution, globalization and liberalization are still opportunities for nations to gain, however excessive and improper liberalization and bias on external factors are critically vulnerable to external shocks, thus appropriate monetary and financial regulations, human resource development, institution building, continuing trade liberalization, are needed in order to mobilize and combine internal and external forces or resources for both short-term and long-term development. In that context, market forces will be further developed while

“the State will continue to be an effective instrument in harmonizing the diversity of benefits which cover such matters as financial, market regulations, job security, environment quality, social security net, and in ensuring that these matters will reinforce the common prosperity” (Pitman Potter, 2000, Pp.1-4). The *open market economy* will continue to be the most effective mechanism to make the best use of the opportunities and benefits and to mitigate the disadvantages that globalization and liberalization bring about, to acquire new knowledge and technologies for the future development of developing economies oriented toward the information-technology or knowledge-based economy, certainly with substantial adjustments.

6.0 CONCLUSIONS, FINDINGS AND IMPLICATIONS

From the above analysis, we finally come to some conclusions, findings and implications, among others.

The first point is that industrialization will continue to be the *must* for developing countries whose economies are still being in an agrarian and backward status like those in East Africa, be it the Strategy of Industrialization Enhancing Dynamic Comparative Advantages (SIEDCA) or another.

Second, to carry out this task of industrialization, the State will certainly need to play the *leading role*, instead of *retreating* as in East Africa today, though how much the market forces are to be unleashed under liberalization and privatization.

Third, though most developing nations want, psychologically, to have a quick and a big catch, including the EAC who planned to raise their real GDP growth rate to at least 7 percent per year from the current rate of 1 to 3 percent per year, or Tanzania planned to attain an average annual growth rate of 8 percent in 25 years from the current growth rates of 3 to 5 percent per year, and to achieve a GDP per capita of US$2000 by the year 2025 from the present $188, experiences in East Asia and elsewhere have proved that *step-by-step or stage-by-stage build-up* have been more successful and faster than big-bang approach and/or rapid liberalization.

Forth, since industrialization is a long and hard cause *pre-conditions preparation* is necessary for the "take-off" period, particularly the development of human resources, the setting-up of market institutions and the building of management capacity and entrepreneurship.

Fifth, though liberalization and reform are very important for more dynamic development, they should not overshadow or underestimate *stabilization*, for stability is the most important factor for development, thus reforms and liberalization are encouraged, but need to be managable or under control.

Sixth, regional and international integration are necessary, but need to *comply* with national strategies and policies.

The success of a nation depends on her *appropriate* and *realistic* development. The Latin Americans achieved a miraculous growth during the 1950s and 1960s thanks to

their earlier reform and large US assistance, but they then failed to do so since the 1970s due to their unmanageable reforms and reduced US support or, in the words of *Maxwell J. Fry,* they lack the "*three key factors"* which resulted in the contrast between East Asian success and Latin American failure, that is, (1) the price stability; (2) the fiscal discipline; and (3) the policy credibility.

As for the East African countries, the past half of a century of their independence without development reminds us that there must be something missing here. That "something" needs to be found. Should it be an industrialization strategy, or else? The future development of these countries depends on their present findings, their choice and their will. If the East Asian experience is selected to be their choice, that would be a good, but also a very hard choice, because the East Africans are in a position not only to make a catch-up like the East Asians did, but also to fill the gap of half a century of stagnation which requires greater efforts to rebuild the present weak capacity of Governments and entrepreneurs, and to raise the current low level of education and skill of the manpower, yet to mention of the eradication of poverty and disease, the building of the infrastructure, and the formulation of necessary market institutions and framework which are mentioned last but not least important.

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