

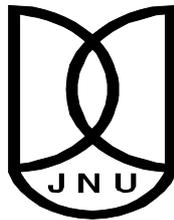
Discussion Papers in Economics

**Economic Development:
Do Governments matter?***

Manoj Pant

May, 2008

Discussion Paper 09-01



Centre for International Trade and Development

School of International Studies

Jawaharlal Nehru University

India

* I would like to thank Mr. Ravi Ranjan for all the research assistance that went into preparing this paper.

(Not to be quoted without permission)

ABSTRACT

Since the Washington Consensus of the early 'nineties, there has been an attempt to define the role of governments in development. After the laissez faire market solution of the Consensus there was view that the success of the 'dirigiste' economies of East Asian economies suggested that the government should play an activist role. The east Asian crisis of the late 'nineties once again turned attention to the role of the government with attention turning to India and China and the 'Beijing Consensus'. In this paper, the development experience of India, China and east Asia is explored in detail over the last fifty years. The paper concludes that the experience suggests that governments do no better than the markets particularly as much of the development of these countries was based on exogenous 'shocks' which no government could have anticipated. The paper concludes that the traditional neoclassical view that governments should restrict their role to providing basic public goods like health and education is probably well founded.

JEL Listing: O16, O19, N01

Economic Development: Do Governments Matter?

One of the contentious issues at the macro level is the role of governments in promoting long term development. Here the debate centres around the role governments can play in micro-management of the economy (see, for example, Timo J. Hamalainen, 2003; Glick et.al. 1997; Eaton and Grossman, 1992; Romer, 1990). To a certain extent, the model for industrialised nations is enshrined in Porter (1990). The issue really is to see what lessons can be drawn for developing countries. In recent decades, one of the earlier views was reflected in the Washington Consensus which gave primacy to the market in promoting development. In this view the freely functioning market mechanism by itself gives the long term direction for developmental activity (Williamson, 2004). However, problems in Latin American countries like Argentina in the late 'nineties made it clear that the Washington consensus was not the panacea for economic ills that it was made out to be (see, for example, Krueger, 2002). A second view on the role of the government was based on the performance of the East Asian 'tigers'. Presumably, governments know best what is in the long term interests of an economy and the 'dirigiste' model of development followed in countries like South Korea, Japan, Thailand etc. was the basis of their success (see, World Bank, 1993; Stiglitz, 1996). The East Asian crisis of 1997 put paid to this view too. Obviously 'dirigiste' governments had also promoted 'crony capitalism' which led to their downfall (Hughes, 1999). After the failure of the Washington consensus and the East Asian miracle, a new approach seeks to idolize the "Chinese miracle". The idea seems to be that China is making traditional models stand on their head and hence are propagating a new economic paradigm. Yet, even this approach assumes that the Chinese program will succeed irrespective of world events and the political economy of liberalization (see Ramo, 2004).

In all this the problem seems to be to find a role for the government in developmental models for developing countries. In particular, can government play a proactive role in guiding development? Is there a common prescription for developing country governments as they strive to catch up with developed countries? Are there any lessons to learn from "good old economics"?

In this article I will look at some post Keynesian development experiences with special focus on Asia and China and India in particular. The focus will be to look at the role the government has played in the development of the sectors which seem to have led the growth story in these countries. I will concentrate on the earlier development periods to see the role governments played in establishing the conditions for takeoff. Hence, I will be particularly interested in the period 1960-1990 which were the crucial periods for most countries in Latin America and East /South East Asia. I will argue that none of these governments anticipated any historical developments and mainly played an enabling role. In fact they simply ‘plugged’ into exogenous favourable international developments that they had not foreseen and gained from this. This also negates views that there is a ‘one size fits all’ approach to development. I will then suggest some areas in which governments must concentrate in providing an enabling environment for development based on the contrasting experiences of East Asian and Latin American countries.

The next section looks at the East Asian success stories. Section III then sets out the factors behind the Chinese ‘miracle’ while Section IV traces India’s recent development successes. In Section V, I look at possible lessons from the Asian and Latin American experiences while Section VI concludes the paper.

II. The East Asian Experience.

There is no doubt that the ‘seventies and ‘eighties were the golden years for growth in East Asian countries which benefited enormously from the growth in world trade following GATT. This is shown in table 1 below.

Table 1: Gross Domestic Product (GDP) Per Capita (in US dollars)

| Country | 1969 | 1970 | 1975 | 1980 | 1985 | 1990 |
|--------------------|------|------|------|-------|-------|-------|
| China | 105 | 122 | 145 | 186 | 288 | 387 |
| Hong Kong | 5545 | 5926 | 7350 | 11245 | 13700 | 18883 |
| South Korea | 1779 | 1886 | 2522 | 3262 | 4440 | 6615 |
| Taiwan | 2252 | 2319 | 2997 | 4483 | 5727 | 8431 |
| Singapore | 3952 | 4415 | 6375 | 8986 | 10652 | 14390 |
| India | 199 | 205 | 212 | 223 | 261 | 320 |

source: <http://www.ers.usda.gov/Data/Macroeconomics/Data/HistoricalRealPerCapitaIncomeValues.xls>

Inspection of Table 1 clearly indicates that the per capita income in the East Asian ‘tigers’ (Hong Kong, Taiwan, Singapore and South Korea) increased enormously in

this period compared to the South Asian countries, India and China. It is interesting to note that in this period India had roughly the same per capita income as China though the gap widened considerably after 1990.

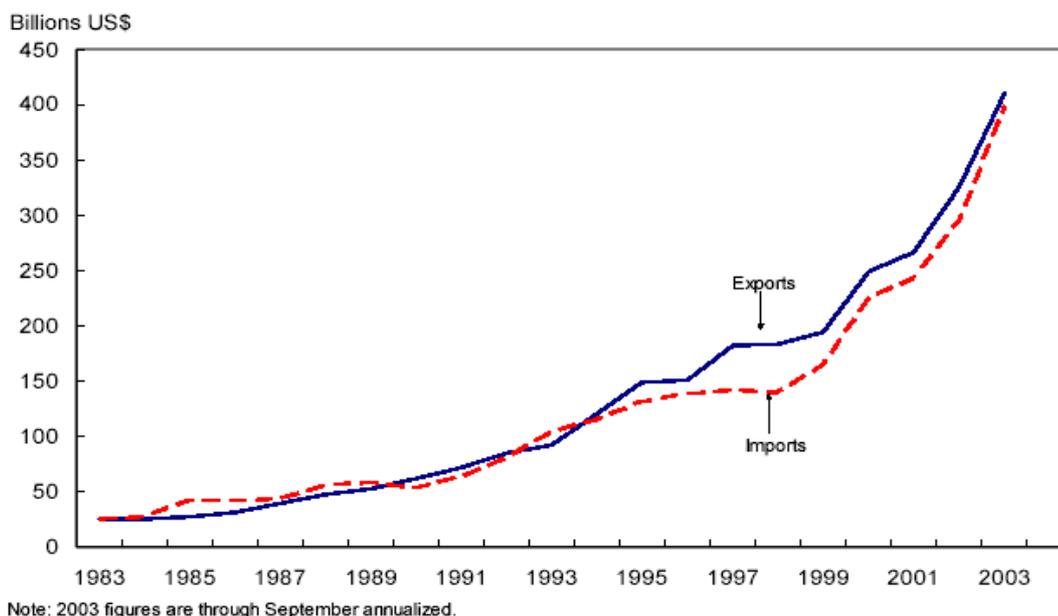
Almost all authors agree that this growth in the ‘tigers’ was export led growth. In this period the real export growth in these countries ranged from 12 to 18 percent per annum (see, Glick et. al., 1997, Table 1). This was substantially higher than the growth rate of world exports (at around 8 percent) and individual country GDPs. It is also accepted that this growth in world exports was principally due to the tariff reductions in developed countries following the GATT agreement of 1948. The East Asian economies simply plugged into this. *Yet, none of these countries were even members of the GATT at that time and hence not automatically entitled to the MFN tariff reductions effected under GATT.* The fact that none of these countries even attempted at that time to become members of GATT shows that they had little anticipation of the benefits that could accrue from growth of world trade. (It is a sobering thought that many countries like India which were founding members of GATT failed to get any benefit from the boom conditions in world trade.) Proactive behaviour of these countries came later in the case of countries like South Korea and Taiwan which attempted to “pick winners” by trying to effect a policy shift from labor intensive sectors to technology intensive areas like machinery and chemicals. There is little evidence that this had any beneficial effects for these economies (see, Desker and Elms, 2005; Choudhry and Islam, 1993). In fact, it has been argued that the policy of ‘picking winners’ may have sowed the seeds for the east Asian crisis of 1997. To take one example, the South Korean government aggressively promoted its automobile company, Daewoo, in its overseas activities. Yet, this prompted the company to take make dubious investments which showed up later in the East Asian crisis of 1997. The subsequent bankruptcy of the company was one of the first indications of the crisis: the bankruptcy was one of the worst in history and Daewoo’s debt of around \$73 billion equaled 20 percent of Korea’s GDP (see, Desker and Elms, op. cit.; Burton, 1999).

III. The Chinese 'Miracle'.

In the second half of this century, the most miraculous growth model has been the Chinese one. China's growth experience dates to as recently as 1980. Prior to this Mao's cultural policy threatened to take China back to the dark ages and seriously disrupted the social and economic climate of the country. The change came only after the reversal of the cultural policy in 1979 when the economy was opened to market influences both internally and externally (see, Singer, 1992). One of the principal internal reforms was the freeing up of private sector incentives in the agricultural sector. The next decade saw an enormous increase in agricultural prices as farmers took to private marketing of their agricultural surpluses (see, Rosen, 1988). More generally, production initiatives were decentralised and benefits passed on the regional town and village enterprises (TVEs) which have been the backbone of China's growth performance (see, for example Naughton, 1994; Chien-Hsun, 1997).

It is instructive to look at some truly remarkable performance indicators for China. One such indicator is its performance in trade and its related experience as home to Foreign Direct Investment (FDI). A snapshot of the trade performance is given in Chart 1 below.

Chart 1: China's Trade in Goods



Source: N. Gregory Mankiw, Testimony Before the House Committee on Ways and Means, Oct. 2003.

From negligible trade in 1980, China has gone on to become an almost \$1 trillion dollar trader today. In fact, as is clear from Chart 1, most of the spurt in trade came after 1991 or so with trade going from less than \$100 billion to over \$400 billion by 2003. The Chinese dominance in trade is such that much so that it has been estimated that the current boom in commodity prices is largely led by enormous demand from the Chinese economy (see, UNCTAD, 2005).

The story of China's remarkable progress is also seen in the inflows of Foreign Direct Investment (FDI). This grew from less than ½ percent of GDP in 1980, to 1 percent in 1985 and 18 percent by 1995. (Source: Twomey, 2000). The most remarkable feature of the growth in FDI has been that it preceded any formal developments in Chinese FDI policy which actually came much later in the 'nineties. In fact it is argued often that bilateral investment treaties (BITs) do not lead to higher FDI as the highest FDI in developing countries in the 1990's has been in Malaysia and China which had no such treaty. In addition, till about 1990 or so the only FDI laws in China were for the purpose of encouraging joint ventures with foreign companies. Beyond this, it was left to local provincial bosses to work out the contractual arrangements with foreign partners (see, Pant, 1995).

The Chinese growth experience, particularly exports, is surely one of the 'miracles' of the last few decades. However, this had little to do with the Chinese government policies and was related to the loss of GSP status of Hong Kong and Singapore around 1988. Since, developed country's tariffs on labour intensive exports were still quite high in the late 'eighties, many of the East Asian economies tried to re-direct their exports via China which still got GSP benefits. It is well known that most of China's industrialisation and export effort was based on provincial village and town enterprises, VTEs, (see, Singer, op. cit.; Rosen, op. cit.). In addition, as noted by Thoburn et. al. (1990) and Chen (1981), the clue to successful operation of a foreign enterprise in China lay in establishing local contacts because of their power in determining the type and length of contracts, freedom to hire and fire etc (see also, Shue, 1988).

This brings us to the crucial role played by 'non-resident' Chinese in Hong Kong (and Singapore, Taiwan) in China's 'miracle'. It is now well recognized that

two-thirds of all FDI in China came from Hong Kong and one third of this went to the Guangdong province largely because of its traditional links with the island state (see, Pomfret, 1989). Hence, the obvious choice of China as the location for FDI (and exports) was dictated by the fact that the Hong Kong businessmen were familiar with Chinese conditions and most had relatives working in the powerful provincial governments (see, Pant, 1995).

This brings us to the other advantage that China had in the growth process: infrastructure. It is well known today that in south Asia, China is today best poised to meet the logistic requirements of large scale exports. *Yet, initially, the development of infrastructure had little to do with Chinese economic perceptions and was driven more by security concerns.* As argued cogently in Rosen (op.cit.), Mao's ideological antibureaucratic preference for local initiatives expressed itself in the Great Leap Forward and the Cultural Revolution. His obsession with security concerns led him to attempt to link the periphery to the centre at the earliest. To take one example, the area of Sichuan and its neighbours to the north, east and south formed the inner security zone and received half the total fixed investment in the period 1964-76. The consequence was a fairly well developed industrial infrastructure in the provinces even prior to 1979 (see, Naughton, 1980).

The relocation of production and export from South Korea to China in labour intensive items like textiles and clothing is also clear from table 2 below.

Table 2: Structure of Trade - 1980 for HK etc. compared with 1990 for China (share of country trade in percent).

| Country | 1980 | | | | 1990 | | | |
|-----------------------------------|-------|-------------|-----------|-----------|-------|-------------|-----------|-----------|
| | China | South Korea | Singapore | Hong Kong | China | South Korea | Singapore | Hong Kong |
| Fuel, Minerals and Metals | 25 | 1 | 28 | 2 | 10 | 2 | 19 | 1 |
| Other Primary Commodities | 28 | 9 | 18 | 5 | 16 | 5 | 8 | 3 |
| Textile and Clothing | 16 | 29 | 4 | 34 | 27 | 22 | 5 | 39 |
| Machinery and Transport Equipment | 5 | 20 | 26 | 19 | 17 | 37 | 48 | 23 |
| Other Manufactures | 26 | 41 | 24 | 40 | 56 | 57 | 25 | 73 |

Source: World Development Report 1982, 1992

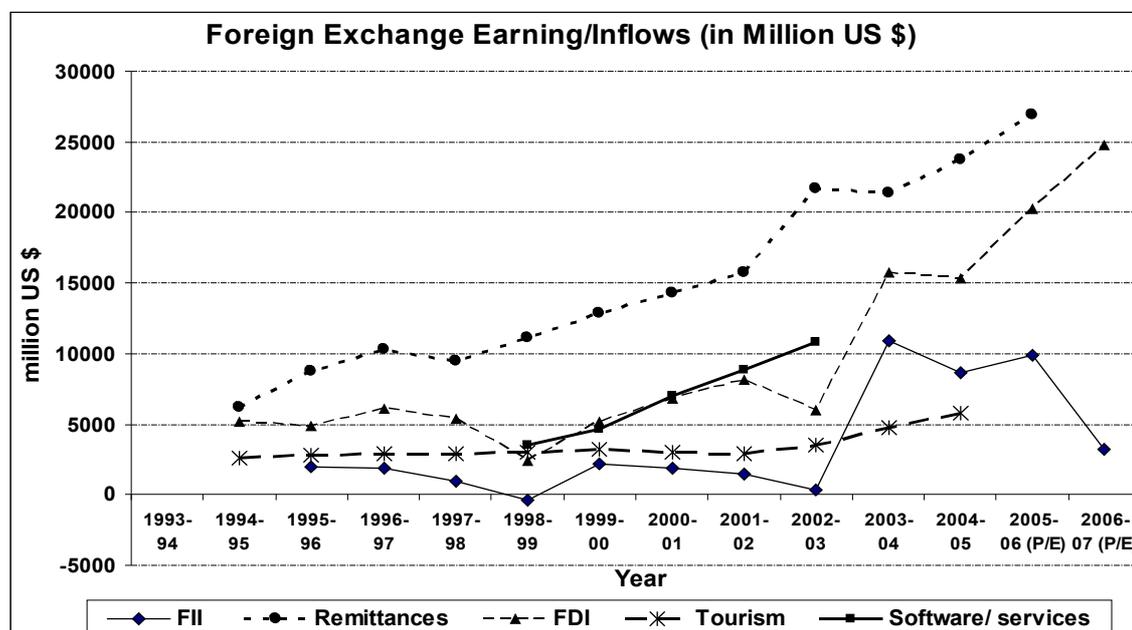
Inspection of table 2 clearly indicates that by 1990, Chinese were gaining export share in textile and clothing exports while countries like South Korea, Singapore and Hong Kong were moving out of textiles into exports of machinery and transport equipment. This of course is typical of the “flying geese” pattern suggested by various authors (see, for example, Balassa, 1965). What we are suggesting here is that cultural and other such factors determined the shift to China rather than to other countries in Asia. *In other words, the push factors in the ‘East Asian tigers’ were more important than the pull factors of Chinese policies.*

IV. The Indian Experience.

As is now well known, in 1991 India replaced the cumbersome system of state controls with a greater role for the market in determining production of commodities and the inflow and outflow of foreign exchange. A study of Indian planning till about 1991 indicates that the two most important constraints to Plan models were foreign exchange and foodgrains. In fact, the foreign exchange constraint was so severe that any proposed production plan was curtailed if it implied any large outgo of foreign exchange. According to the 1991 Industrial Policy of Government of India, imports of capital goods (of more than Rs 2 crore) required clearance from the Secretariat for Industrial Approvals (SIA) in the Department of Industrial Development according to availability of foreign exchange resources (see <http://siadipp.nic.in/publicat/nip0791.htm>). In fact, the 1991 economic reforms were made possible as part of a urgent response to the impending default on international payments. Since then, of course there has been a sea change in the external payments position and India now has a comfortable foreign exchange reserve position of more \$ 300 billion.

How has the structure of India’s trade balance changed since 1991? Actually, barring a few years in the early years of this decade the trade balance has continued to be in deficit. The main difference has been the increasing and large surpluses in the balance on invisibles trade. In addition, there have been increasing inflows in the capital account. These inflows are shown in Chart 2 below.

Chart 2: Foreign Exchange Earning/Inflow of India (in Million US \$)



Source: Calculated from data of the Reserve Bank of India.

Inspection of Chart 2 indicates that the usual foreign exchange earner (tourist trade) has been replaced by inflows on account of export of software services and remittances (in the current account) and foreign direct investment (FDI) in the capital account. While remittances have continued to play an important role as in the 1970s, the nature today is different. In the 1970s remittances were mainly from Indian workers in the gulf areas. Today, they have been replaced by inward remittances from Indian workers in the software and similar higher end sectors in the developed countries for example, remittances from United States as a share of total remittances to India grew from 37 percent in 1997 to 51 percent in 2003 (World Bank, 2006). It is also common knowledge now that the sunrise sector which has led to a sea change in India’s foreign exchange earnings has been the information technology (IT) sector.

India’s IT story began in the late ‘nineties with the well known “Y2K” problem. The computer industry was grappling with the problem of revised dating in computers when the new decade started in 2000. The actual work involved writing simple but laborious programs to address the problem. The main industry affected by this was the software industry of the ‘Silicon valley’ in California, USA. The

problem needed particular attention as the worldwide internet was leading to an exponential growth in trade in IT embodied services. It is now well known that most of the Silicon Valley labour intensive software operations were relocated to India. More specifically, the first relocation took place in the city Bangalore in the early part of this century. Subsequently, the IT industry has spread to other parts of India. What proactive role did the government play in developing the IT sector? We will look at this issue in the context of three factors that are considered to have contributed to developing India's capacity in the IT sector.

The first factor relates to why the IT sector came to be located in India and, more specifically, in the southern city of Bangalore? This is what we might call the "Non Resident Indian (NRI) factor". The following quotation from a newspaper is instructive.

"No exact figures are available but inside estimates put Asians at 20% of Silicon Valley's upper management and 40% of its professional and technical work force." (GoldseaAsian Air, June, 2002)

In relocating the industry to India, rather than to other more investor friendly areas like Philippines or other South East Asian countries, a major factor was where the NRIs would want to relocate. It is also true that many of these NRI actually came from the southern part of India and this determined the choice of Bangalore. In fact, till the advent of the IT industry, the city of Bangalore was only known as the place where retired Indians often relocated due to the moderate weather conditions. Hardly a natural choice for unbiased international investors. To that extent, the NRIs have played the same role in India's IT sector as the non-resident Chinese in Hong Kong played in China's textile manufacturing sector.

The second factor accounting for India's success in the IT sector has been its availability of 'English speaking' educated labour force. The facts however indicate that the Indian policy (both at the federal and the Central level) has always worked to negate this advantage. This is clear from a study of the language policy of Indian states. In this it must be remembered that the education sector (where the applicability of the language issue is most relevant) in India falls in the concurrent list of the Constitution so that both Central and federal governments have considerable influence. The following paragraphs have been culled form various policy documents and reflect official position on the language issue.

It is seen that the *mother tongue or regional language is the medium of instruction at the primary stage of education in most of the States/UTs*. However, facilities for studying in a medium other than regional language vary considerable in different States and Union Territories. Teaching of English is compulsory in all the States/UTs, except Bihar. However, the classes in which teaching of English is compulsory differs form State to State. In general, it is compulsory in Classes VI-X in most of the States/UTs.

After Independence a large number of States changed over gradually from English to the regional languages as media of instruction at the secondary and higher secondary levels. Some States like Andhra Pradesh, Bihar and Maharashtra, simultaneously allowed institutions run by the linguistic minorities to have their languages as media of instruction, while in most States the Government run institutions offered only the regional language as the medium of instruction at the secondary and higher secondary stages of education. The States of Andhra Pradesh, Karnataka and Tamil Nadu issued orders for provision of facilities in teaching through the medium of minority languages if there are 10 pupils in a class or section, or 30 pupils in the whole school.

(see, <http://education.nic.in/cd50years/u/47/3Y/473Y0504.htm>)

Further perusal of state level policies gives us the following-

Uttar Pradesh: Until May 1949, both Hindi and Urdu were the medium of instruction at the primary level. Also elementary Urdu was taught to those whose mother tongue was Hindi and vice versa. Form class VI onward the medium of instruction was English but both Hindi and Urdu were allowed as additional media of examination. In May 1949, Hindi was made the sole medium of instruction at the primary and secondary levels. (see, <http://education.nic.in/cd50years/u/47/3Y/473Y0504.htm>)

Karnataka: The choice of medium of instruction in Karnataka was also based on the statements in the Constitution and the Grant-in- Aid Code of the State government since Oct 19, 1969. According to this arrangement, 'In all primary schools the medium of instruction shall ordinarily be the Regional Language or mother tongue of the child'. The English medium schools or English medium sections in the primary schools were permitted by the Director of Public Instruction to cater to the needs of migratory groups and 'Students whose mother tongue is a

minority language for which there is no provision in the schools of the locality. (see, <http://www.languageinindia.com/dec2002/karnatakaeducationpolicy.html>)

The above information has been obtained from education department sources of the government of India and the states. The main point here is that the *language policy (even in recent times) has never tried to promote the use of English as a medium of instruction*. The fact that the country still has a large population with a reasonable command of the English language is more of a historical accident than a part of any conscious government policy at the Central or state level. *If anything, the proliferation of English owes much more to inter state migration and market forces.*

The third factor, often quoted as being the principal factor behind the successful development of the IT sector, is the availability of a trained labour force coming out of the Indian higher education sector. Let us see this in some more detail.

What commentators often remark is the ready availability of educated university graduates for the IT industry. But this ignores the fact that the policy makers have, in the past, viewed higher education mainly as a ‘social policy’. In other words, the objective of secondary and tertiary education has been mainly to ‘keep the youth off the streets’. While this may have been justified fifty years ago, it has now led to the problem of a surplus of unemployed graduates. So we have the paradox of a growing army of unemployed graduates while the private sector complains of a lack of ‘skilled’ labour force. According to the 2001 Census data, of the total number of educationally qualified people (matriculation and above) of about 500 million, *only about 38 million were university degree holders out of which 26 million were non-technical graduates* and only four million had a post-school technical diploma. Worker participation rate (WPR) for graduates and above (other than technical degree holders) was 60.9 percent where as WPR for technical degree or diploma (equal to degree or post-graduate degree) holders was 67.9 percent. In other words, the largely state promoted higher education sector was not producing any graduates with the kind of computer proficiency required in the IT sector. In recent years it is the private sector which has been filling in the gaps. Even today, the state higher education establishments can only accommodate about 10 percent of the school educated labour force.

To summarise, the response of the government to developments in the IT sector have been reactive rather than proactive, mainly because the government could

not have predicted the rise of the IT sector. One telling evidence is that in 1995, during the formative years of the WTO, the Indian government was in the forefront of the developing countries arguing for a weaker agreement on trade in services (GATS) to prevent excessive dominance of developed countries (see, Pant, 2001).

V. Education and Government in East Asia and Latin America.

Does the above indicate that the government has no role to play in development? On the contrary, what we are arguing is that fortunes of countries are often a function of exogenous events at the national or international event. Attempts by governments to actual control or direct these events may have disastrous consequences. Yet, the government has a crucial role in providing the enabling environment. In India, for example, the most important enabling environment was provided by the economic reforms of 1991 and the Industrial Act, 1992. In China a similar environment was created after the reversal of Mao's 'cultural revolution' after 1979 and the opening up of the agricultural and industrial sectors to private initiative. Yet, this is not enough and here the old principle of public economics still holds good: the job of the government is to provide public goods where market failure is typical. This is particularly important in democracies where increasing inequality of incomes can stymie all growth efforts. A good example to illustrate this point is the relative experience and performance of the Latin American and South East Asian economies in the period 1960-1990.

The problem with cross-country comparisons is to find episodes which come close to being some kind of "controlled experiments" where the countries under comparison were subjected to somewhat similar exogenous economic forces. One such episode is the growth experience of Latin America (LAC) and South East/East Asia (SEA) in the period 1960-80. The exogenous force was trade liberalisation following GATT in 1948. Tariff reduction was not then mandatory for these countries. In fact, both sets of countries practiced import substituting industrialization under almost similar high tariff barriers. In both the LAC and the SEA the median average tariff was around 30 percent in 1980 and thus fairly protective. Subsequently, both reduced their tariff levels to around 15 percent by the end of the decade. (see, UNCTAD, 2007)

This was also the period where both countries gained access to world markets for exports of labour intensive items as GATT led to substantial tariff reductions in developed countries. In the period, 1950-80 real growth of world trade was around 8 percent per annum. It is now well known that the SEA economies plugged into this growth much more aggressively than the LAC with export growth rates of 12 to 18 percent per annum as compared to around 4 percent for Argentina and 8 percent for Brazil.

To complete our experiment, these were also the two areas where Foreign Direct Investment (FDI) concentrated though in SEA the origin was Japan and in LAC, the Americas and Europe.

The comparison for GDP growth rate and per capita GDP is also well known. As shown in Table 3 while in 1970 per capita income in both areas was around \$2000 but by the end of the 'eighties four of the SEA countries (South Korea, Hong Kong, Singapore and Taiwan) had per capita incomes twice that of the LAC.

Table 3: Per capita GDP and GDP growth rage

| | Real 2000 GDP Per Capita (\$) | | | Annual Growth Rates' | | |
|--------------------|-------------------------------|--------|--------|----------------------|-------|-------|
| | 1970 | 1980 | 1990 | 1970 | 1980 | 1990 |
| Brazil | 1,987 | 3,482 | 3,312 | 5.85 | 6.52 | -5.67 |
| Chile | 2,242 | 2,510 | 3,070 | 0.28 | 6.48 | 1.91 |
| Mexico | 3,430 | 5,058 | 4,873 | 3.14 | 6.8 | 3.22 |
| Argentina | 6,621 | 7,482 | 5,672 | 5.58 | 2.43 | -1.15 |
| South Korea | 1,886 | 3,262 | 6,615 | 6 | -3.61 | 7.4 |
| Taiwan | 2,319 | 4,483 | 8,431 | 2.98 | 4.93 | 4.75 |
| Singapore | 4,415 | 8,986 | 14,390 | 11.69 | 8.31 | 5.78 |
| Hong Kong | 5,926 | 11,245 | 18,883 | 6.88 | 7.46 | 2.91 |

Source: <http://www.ers.usda.gov/Data/Macroeconomics/Data/HistoricalRealPerCapitaIncomeValues.xls>

As table 4 shows, the income inequality (as measured by the Gini coefficient) in the slower growing LAC actually increased in the period 1960-80 but fell or did not increase in the faster growing SAE economies. What this indicates, is that growth does not necessarily have to be at the expense of equity in income distribution.

Table 4: Income inequality in Latin America and South East Asia, 1960-80

| Country | Gini Coefficient | | |
|------------------|------------------|------|------|
| | 1960 | 1970 | 1980 |
| Brazil | 55 | 59 | 56 |
| Argentina | 43 | 41 | 42 |
| Chile | 46 | 50 | 53 |

| | | | |
|--------------------|----|----|----|
| Hong Kong | 50 | 43 | 39 |
| Malaysia | 57 | 52 | 51 |
| Philippines | 50 | 48 | 44 |
| Indonesia | 39 | 35 | 36 |

Source: World Income database, May 2007, United Nations University

So what exactly did the SEA do that the LAC did not? Two things actually, one, they plugged into world trade growth by aggressive export promotion. Between 1960 and 1990, the ratio of exports to GDP (one measure of openness) for SEA went up from an average of around 70 percent to around 90 percent. In the LAC it remained around 5 percent for Argentina and Brazil.

Second, as a number of studies now show (see, for example, Birdsall et. al., 1996), the SEA countries ensured growth without an increase in income inequality by investing heavily in education. In other words, it was far more successful than the LAC in ensuring that its workers were ‘enabled’ to participate in the growth. To take one example, by 1990 the coverage of basic education in Brazil was much smaller than the SEA despite both starting from around the same base in 1960 (Birdsall et. al., 1996 op. cit.). The reasons for this was rapid increase in GDP, decline in number of children eligible for education (due to decline in birth rates) and steady and large increase of public spending on education.

It has been argued that developing countries tend to devote a larger part of their public spending on higher education relative to primary education.(see Tilak, 1982). This is where the LAC countries have been one exception. Thus, for example, the shares of public expenditure devoted to higher education in 1950, 1970, and 1994 were considerably lower in Korea and Japan compared to Latin American countries. In fact, SEA governments have been highly committed to providing broad based, quality education by allocating a high share of their public expenditure on education to basic education (including pre-primary, primary and secondary school) (Cardoza, 1996). In general, private financing played a major role in higher education in East Asian countries such as Japan, Korea and Taiwan (see Birdsall et. al., 1996; Cardoza, 1996).

This point is brought out clearly in Table 5 below which shows the change in public investment in education per pupil over the period 1970 and 1989 in Brazil and South Korea.

Table 5: Public expenditure on basic education per eligible child and some other determinants

| Country | 1970 | 1989 | % Change (1970-1989) |
|--|-------------|-------------|---------------------------------|
| Korea | | | |
| Expenditure on basic education per eligible child | \$95.3 | \$433.4 | 354.8 |
| Public expenditure on basic education as % of GNP | 3.1 | 2.7 | -12.9 |
| Index of absolute expenditure on basic education | 100 | 444 | |
| Number of children eligible for basic education (thousand) | 10074 | 9848 | -2.2 |
| Brazil | | | |
| Expenditure on basic education per eligible child | \$58.6 | \$170.8 | 191.5 |
| Public expenditure on basic education as % of GNP | 1.7 | 2.1 | 23.5 |
| Index of absolute expenditure on basic education | 100 | 316 | |
| Number of children eligible for basic education (thousand) | 32542 | 35319 | 8.5 |

Note: Absolute expenditure on basic education in real 1967 U.S. dollars used to calculate indices. Number of children eligible for basic education calculated using enrollment rates and number of students in 1st and 2nd levels i.e. (Number of enrolled student X enrolled) = number of those in age group eligible for basic education.

Source: Birdsall et. al., 1996, p. 16.

Inspection of Table 5 shows that the much higher growth rate and expenditure in Korea on basic education has implied that the number of eligible children for this expenditure has declined between 1970 and 1989 in contrast to Brazil. This shows the success of the educational policy of South Korea vis a vis Brazil.

VI. Conclusion.

There has been intense search for a model of development which will fit at least the category of newly developing economies. In recent years the concentration has been on India and China while a decade back the focus was on the so called East Asian ‘tigers’. In particular the debate has centred on whether the government can play a pro-active role in the development process.

In this article we have looked at the sectors which provided the impetus to development in China, the East/South East Asian economies and India. What we have tried to argue is that in all the cases the impetus came from exogenous international factors which none of these countries could have foreseen. In fact, going by the experience of the East Asian economies, we have argued that attempts by governments to micro-manage the industrial sector may have made matters worse in terms of long run costs to the economy.

The main role of the government seems to be to recognize the exogenous factors and create the enabling environment for benefiting the economy. In general, the principal response of the government seems to be to open up the economy to external influence. However, this alone is not enough as it may not lead to sustainable growth in democracies if income distribution worsens as a result of openness. To prevent worsening of income distribution it seems necessary for the state to invest in education so as to enable its population to participate in the growth process.

However, investing in education alone also does not seem to be enough. Here, we looked at the relative experience of the Latin American economies and the East Asian economies to show that one major factor behind the sustainability of the growth process in east Asian economies was their investment in basic education rather than higher education. This enabled them to create a large educated labour force which could plug into the growth.

In conclusion, the standard prescription of traditional economics seems to hold the key. The governments of developing countries need to provide public goods in the form of basic education to the population. This allows the population to be part of the growth process and reduces the pain of structural adjustment that any growth process must entail. However, a proactive role of the government in actual industrialization is unnecessary and may make matters worse in the long run.

References:

- Balassa, B. (1965), 'Trade liberalisation and revealed comparative advantage', *Manchester School of Economics and Social Studies*, Vol. 33 pp.90-124.
- Behrman, Jere R., Duryea, Suzanne and Székely, Miguel (2000), 'Households and Economic Growth in Latin America and the Caribbean', Global Research Network Project on Explaining Growth, February 2000. Available at www.lacea.org.
- Birdsall, Nancy., Bruns, Barbara. and Sabot, R. H. (1996), 'Education in Brazil: Playing a Bad Hand Badly', appearing in "*Opportunity Foregone: Education in Brazil*", edited by Nancy Birdsall and Richard Sabot. Johns Hopkins University Press. Pp. 7-48.
- Burton, John. (1999), 'Controlled Implosion', *Financial Times* (London), November 5, 1999.
- Cardoza, Guillermo (1996), Higher Education and Research and Development (R&D) in East Asia and Latin America: Different Perspectives?', LASPAU – HIID – HGSE 30th Anniversary Symposium Higher Education in Latin America: The challenges of the market and institutional reforms, Harvard University, Cambridge, Nov 6-8, 1996. Available at www.aair.org.
- Chowdhury, Anis. and Islam, Iyanatul. (1993), '*The Newly Industrialising Economies of East Asia*', Routledge.
- Chen, E.Y.K. (1981), 'Hong Kong Multinationals in Asia: Characteristics and Objectives', in Kumar, K and Mcleod, M.G. (eds.), *Multinationals from Developing Counties*, Lexington Books, MA 1981.
- Chien-Hsun, Chen. (1997), 'Impact of Local Determinants on the Evolution of Township-Village Enterprises in China's Transitional Economy', *Journal of Economic Development*, Vol. 22. No. 2, December 1997. pp. 133-145.
- Colclough, C. and Al-Samarrai, S. (2000), 'Achieving Schooling for All: Budgetary Expenditure on Education in Sub-Saharan Africa and South Asia', *World Development*, Vol. 28, No. 11, pp. 1927-1944.
- Desker, Barry. and Elms, Deborah. (2005), 'The East Asian Experience: The Poverty of "Picking Winners"', Presented at the Conference on Globalization and Economic Success: Policy Options for Africa, Singapore, 7-8 November 2005. Available at http://www.thebrenthurstfoundation.org/Files/Globalisation_and_Economic_Success_Singapore_2005/East_Asian_Experience.pdf.
- Eaton, Jonathan and Gene Grossman, (1992), 'Optimal Trade and Industrial Policy under Oligopoly,' in Gene Grossman (ed.), *Imperfect Competition and International Trade*, Cambridge, MA: MIT Press.

- Glick, Reuven, and Moreno, Ramon (1997), 'The East Asian miracle: growth because of government intervention and protectionism or in spite of it?'. *Business Economics*, 4/1/1997.
- Hamalainen, Timo J. (2003), *National Competitiveness and Economic Growth: The Changing Determinants of Economic Performance in the World Economy*. Edward Elgar Publishing Ltd.
- Hughes, Helen. (1999), 'Crony Capitalism and the East Asian Currency Financial 'Crises'', *Policy*, Spring 1999. Available at <http://www.cis.org.au/POLICY/Spr99/spr99-1.pdf>.
- Krueger, Anne. (2002), 'Crisis Prevention and Resolution: Lessons from Argentina.' Speech to National Bureau of Economic Research Conference on "The Argentina Crisis." Cambridge, MA (July 17). Available at <http://www.imf.org/external/np/speeches/2002/071702.htm>
- Mankiw, N. Gregory (2003), 'Testimony before the House Committee on Ways and Means', Oct. 2003.
- Mingat, Alain and Tan, Jee-Peng, (1986), 'Financing Public Higher Education in Developing Countries: The Potential Role of Loan Schemes', *Higher Education*, Vol. 15, No. ¾, 1986, pp. 286-297.
- Naughton, B. (1980), 'The Third Front: Defence Industrialisation in the Chinese Interior', *China Quarterly*, No. 115, Sept. 1980.
- Naughton, Barry. (1994), 'Chinese Institutional Innovation and Privatization from Below', *The American Economic Review*, Vol. 84, No. 2, (May, 1994), pp. 266-270.
- Pant, Manoj. (1995), *Foreign Direct Investment in India – The Issues involved*, Lancers Books, New Delhi.
- Pomfret, R. (1989), 'Ten Years of Direct Investment in China', *Asia Perspective*, Fall/Winter.
- Porter, Michael (1990), *The Competitive Advantage of Nations*. The Free Press, New York.1990.
- Ramo, J. Cooper. (2004), *The Beijing Consensus*, The Foreign Policy Centre, The Mezzanine, Elizabeth House, 39 York Road, London.
- Romer, Paul. (1990), 'Endogenous Technological Change', *Journal of Political Economy*, 98 (October).
- Rosen, G. (1988), *Contrasting Styles of Reform: India and China in the Eighties*, University of Chicago Press.
- Singer, H.1992. Lessons of post-war development experience, 1945–1988. In S Sharma, Editor, *Development Policy*, Macmillan, London (1992).
- Shue, V. (1988), *The Reach of the State*, Stanford.
- Stiglitz, J.E.(1996), " Some Lessons from the East Asian Miracle", *World Bank Research Observer*, vol. 16, no.2, pp. 151-177.
- Thoburn, J.T., Leung, H.M., Chan, E. and Tang, S.H. (1990), *Foreign Investment in China Under the Open Policy*, Avebury, Brooklyn.

- Tilak, J.B.G., (1982), 'Educational Planning and the International Economic Order', *Comparative Education*, Vol. 18, No. 2, 1982, pp. 107-121.
- Twomey, M. J. (2000), '*A Century of Foreign Investment in the Third World*', London: Routledge.
- UNCTAD (2005), '*Trade and Development Report*', United Nations, New York and Geneva.
- UNCTAD (2006-07), '*Handbook of Statistics*', United Nations, New York and Geneva.
- Williamson, John. (2004), 'A Short History of the Washington Consensus'. Paper commissioned by Fundación CIDOB for a conference "From the Washington Consensus towards a new Global Governance," Barcelona, September 24–25, 2004. Available at www.iie.com/publications/papers/williamson0904-2.pdf.
- World Bank, (1993), '*The East Asian Miracle, Economic Growth and Public Policy*', A World Bank policy research report (No. 12351), 1993/09/30, Oxford University Press.
- World Bank, (2006), 'Trends, Determinants, and Macro Economic Effects of Remittances', *Global Economic Prospects 2006*. Pp. 85-115. Available at http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2005/11/14/000112742_20051114174928/additional/841401968_200510319015205.pdf.