East Asia’s inclusive growth model [Part – I]

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Almost thirty years ago the World Bank produced a seminal report, ‘The East Asia Miracle’, which captured the essence of the success stories of eight economies in East Asia (Japan; the four tigers – Hong Kong, Singapore, Korea, Taiwan; and three Asean countries – Indonesia, Malaysia and Thailand).

These high-performing economies grew three times as fast as Latin America and South Asia and five times faster than Sub Saharan Africa between 1965 and 1990. During the 1990s, the high growth momentum was sustained, and these economies grew at average 8 percent per annum. Their share in world trade expanded at a rapid pace and per capita incomes increased manifold but their income distribution also improved as the benefits of growth were widely shared and not limited to a small segment of population.

These were the only economies during those 25 years that recorded high growth, poverty reduction and declining inequality. Japan’s per capita income reached 85 percent of the US in 1990 (although it has since declined to 70 percent). The East Asia Miracle study found that the rapid growth of these countries had two complementary elements. First, getting the fundamentals – high levels of domestic savings, broadly based human capital, good macroeconomic management, openness to trade, foreign direct investment; and technology – was essential.

Second, policy interventions by the government were designed in a way that kept the costs within well-defined limits. Price distortions were mild, interest rate controls used international interest rates as a benchmark and explicit subsidies were kept within fiscally manageable bounds. Given the overriding importance to macroeconomic stability, interventions that became too costly or otherwise threatened stability were quickly modified or abandoned.

At the time of the publication of the World Bank report, there was a lot of controversy about the factors underpinning these countries' success. A group of economists ascribed the success to competitive market forces, openness to trade and investment, outward orientation and integration with the world economy. An opposite viewpoint was advanced by Robert Wade and Alice Amsden who argued that proactive government intervention in selecting certain sectors of the economy and providing them with concessional financing, foreign exchange, tax exemptions and subsidies was responsible for the East Asian economies' exceptional performance.

In my view, we have now plenty of empirical evidence that this binary – markets vs government – is no longer valid and has become outdated. We need both a strong and effective government and well-functioning competitive markets regulated by the government. The public and private sectors should work in partnership for common agreed goals, each where they have comparative advantage. There are both market failures and government failures and as long as these failures can be redressed the country moves on the right track.

Global financial crisis, pandemics, inequality and the climate change agenda have convinced us that timely and appropriate government interventions are required to address these issues whereas the government should keep its hands off from running businesses as experience with the public sector running business enterprises has not been very successful in many countries .

There was scepticism also about the sustainability of the East Asian model over time. Paul Krugman, the Nobel Prize winning economist, argued that the huge increases in GNP attained by the East Asian countries were input driven – from heavy capital investment, large savings, sharply rising educational levels – and will quickly level out because they will not be followed by significant increase in productivity. The World Bank study had shown that one-third of growth of these economies was attributable to increased efficiency or total factor productivity. This was large relative to other countries and as a share of output growth.

A more recent 2018 study that updates the productivity growth since 1990 provides evidence that East Asia's productivity has been gradually catching up with the US. Productivity growth has been faster than in other low-and-middle income countries. Firms became more productive due to better technology and management practices. Labour moved from low to high productivity activities which raised the relative share of incomes held by the bottom 40 percent of the population. This reallocation contributed to income growth and ultimately to poverty reduction.

This group of eight has since been joined by China in the 1980s after Deng Xiao Peng opened up the economy, allowed the private sector to fully participate in the economy and welcomed foreign investment and later by Vietnam which abandoned its old inward-looking command and control economic model and integrated itself with the world economy on the same lines as China, albeit with some differences but retaining the essential ingredients. The East Asian growth model is rightly termed as a shared or inclusive growth model under which the majority of the population has benefitted from the rising tide; it has a lot of lessons to offer for other developing countries.

Thirty years after the miracle study there is overwhelming evidence that the East Asian economies have not only done extremely well in terms of economic growth and poverty reduction but also successfully weathered the crisis of 1997, 2008 and pandemic in 2020 and did better than other developing countries. Since 2000, its GDP has risen more than three-fold – lifting over a billion people out of poverty. They are on the transition path from the middle to high income level. Social indicators have made equally impressive gains. School enrolment, educational attainment, infant mortality, child mortality, improved water source and sanitation look much better than what they were in the early 2000s. Gaps between male and females in labour force participation, wages and educational attainment have also narrowed.

Asia's share in world GDP (at PPP) has risen from 24 percent in 1973 to almost 40 percent. Foreign currency reserves of Asian central banks now account for 70 percent of the world currency reserves and financed more than half of the current account deficit of the United States.

Of course, Japan which had taken the lead in the post-World War II era and now one of the advanced countries is facing a different set of problems that beset mature economies exacerbated by an ageing population that has shrunk its working labor force. Four other countries from the original eight have also crossed over to high income group. Korea has already joined the OECD. Taiwan has per capita income of over $32000 and is one of the power houses for technology, particularly semi-conductors. Singapore and Hong Kong are also high-income countries according to the World Bank classification by income and their export/GDP ratios exceed 200 percent.

These countries are no longer included in the East Asian Developing or Emerging countries group as they are no longer in the same economic transformation mode as other countries. So, the group of East Asian developing economies now consists of the original three – Malaysia, Indonesia, Thailand – joined by China, the Philippines, Vietnam, Cambodia, Laos, Myanmar.

In 1980, China was among the world's poorest countries with 80 percent of the population with incomes less than $1 per day and only a third of all adults able to read or write. Its per capita income was identical to that of India. By 2000, the proportion of the poor (income less than $1 per day) had declined to around 16 percent. Between 2008 and 2018, China's GDP rose four-fold from $4.6 trillion to $18 trillion, making it the second largest economy in the world (in nominal dollar terms) and today its per capita of $10,000 is five times that of India.

More remarkable is its achievement in lifting an astounding 700 million of population out of poverty with 500 million enjoying middle class lifestyles. China is today the world's largest exporting nation with the highest foreign exchange reserves in the world of $3.2 trillion equivalent to 13 months imports. Korea and Pakistan had identical per capita incomes of $100 in 1960. Korea has now graduated as an OECD country and reached per capita income of approximately $27,500 while we haven't even crossed the threshold of $1600.

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