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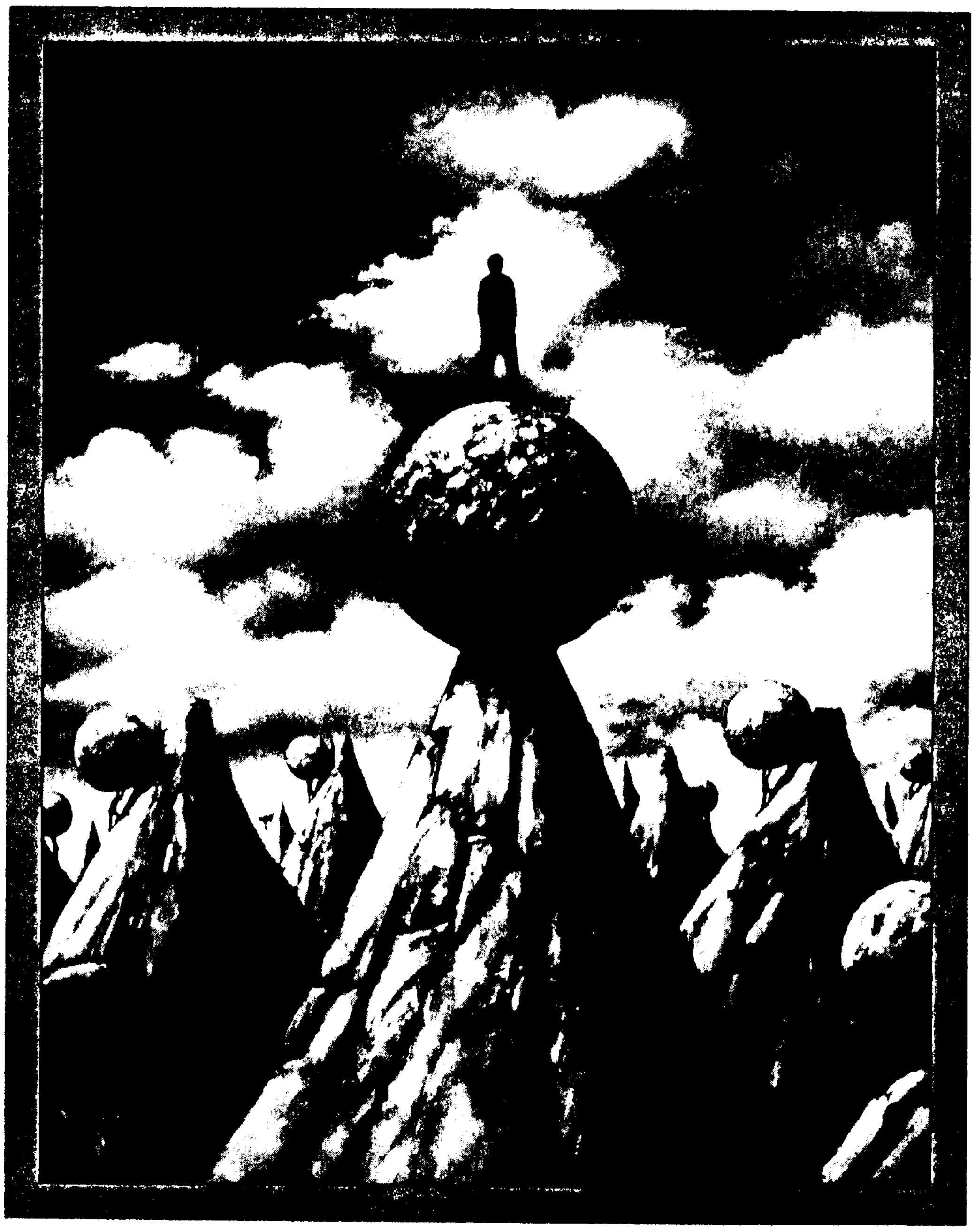

PEOPLE:
FROM IMPOVERISHMENT TO EMPOWERMENT

Section 3

Lessons to Be Learned from East Asian Economies

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The post-war development experiences of many East Asian economies illustrate that the right type of economic development can reduce poverty and create employment in poor, developing countries. The most important lesson is that economic development should be market driven. This allows the economy to grow on a broad base and maintain high rates of growth, so that benefits can be widely shared within the population to avoid social divisiveness.

Most East Asian economies followed market-oriented development strategies. In doing so, they by and large developed economic activities in which they had a comparative advantage. This is not to claim that the state did not intervene in the market, but that most of those interventions did not try to pursue grand strategies that were in conflict with market signals. Most of those interventions were piecemeal in nature, and seldom implemented on either a massive scale or were maintained for prolonged periods of time—unless they were successful. Grand strategies required the state to suppress market forces, distort the price structure, and impose regulatory constraints that generate huge economic losses. Imbalances between supply and demand created by such intervention have to be rationed by costly administrative measures. Efforts to circumvent controls beget further controls and lead to even greater distortions and higher costs.

Distortionary regulations create formidable barriers to economic entry, retard economic growth, and lead to a narrow base of economic activities that benefit the privileged. Income and wealth disparities that stem from such discriminatory regulations are socially divisive; they foster a deep sense of envy, frustration, and alienation. On the other hand, dispersions in income and wealth that result from equal competition in the marketplace provide incentives for participants to seek to advance oneself and one's family through work and savings, to respect the fruits of others' labor, and to make for a more cohesive and self-assured society. A broad base of economic activities also creates a more resilient economy, makes high growth rates sustainable, and speeds up the trickle-down process.

Dangers of Grandiose Strategies

Many developing countries try to achieve economic progress by pursuing various grand strategies and development plans based on specific goals. These strategies and plans often entailed the adoption of policies that suppressed market forces and resulted in a huge loss of economic efficiency, lower growth rates, and a narrow and precarious economic base. This allowed scarce resources, especially human resources, to become unemployed or underemployed. The poor invariably become the worst victims of these unfortunate policies.

It is useful to consider the following, stylized example to examine the logical implications of what took place in many developing and socialist economies. Many labor-abundant agricultural economies pursued rapid industrialization through promoting capital-intensive industries at the expense of more labor-intensive industries, services, and agriculture. Such a developmental strategy required resources to be allocated to capital-intensive industries through a variety of administrative means. The price structure was severely distorted, and extensive rationing had to be relied upon. Control measures proliferated as market forces tried to circumvent earlier imposed controls. Sometimes, widespread nationalization and the adoption of national economic planning became necessary tools for the state to achieve its purposes.

In impoverished economies, promoting capital-intensive industries meant working against market forces. Since the return from investing in capital-intensive industries can only be realized after a long period of time, a rapid rate of capital accumulation has to be secured by artificially boosting profits through the manipulation of price and cost structures. The cost of using capital was lowered by suppressing interest rates. The cost of foreign exchange was depressed to protect these industries from foreign competition and to lower the cost of importing essential facilities and equipment used to develop capital-intensive industries.

Wage rates were kept down by providing basic necessities consumed by urban workers at very low prices by exploiting the rural sectors; for example, food prices had to be depressed. Monopoly state-marketing boards were relied upon to compel raw material and agricultural suppliers to sell to the state at administered low prices. The state-marketing boards practically eliminated agricultural and primary-commodity markets. As incentives were curtailed, productivity sagged. Many poor peasants fell heavily into debt, some sold or abandoned their land, and others migrated to the cities and became urban squatters. In some places, urban to rural migration was resisted by denying services to immigrants. Even more draconian and coercive measures were also employed from time to time.

Flow of Resources

Nevertheless, these controls could not always guarantee that resources would voluntarily flow toward the capital-intensive industries that the state favored. Competitive private enterprises have little incentive to reinvest their earnings in low-profit industries. To encourage their development, many enterprises were granted subsidies, monopoly rights, or became outright, state-run monopolies. In the extreme case, a highly coercive, administered system of managing resource flows became imperative. National economic planning was also pursued in some instances and became an indispensable tool for pursuing policy goals that had to work against market forces.

Within the urban sector, employment opportunities were few for dwellers in the shanty towns, because most resources were invested in heavy industries that created few jobs. Regulatory restrictions that discriminated against light industries and services made it difficult to set up legitimate practices within the formal economy.

Investment in residential and other structures was severely hampered by the absence of property titles that provided security of ownership and tenure. The absence of significant housing investments, provided through the market, prevented the housing industry from becoming a major competitor for resources that could be used for industrialization. In a sense, the housing market could not be allowed to function.

The result of many of these grand strategies was to generate severe imbalances in various markets, such as credit markets, foreign-exchange markets, commodity and raw material markets, and agricultural markets. Foreign-exchange controls, credit rationing, and state-marketing boards had to be maintained, and this had economy-wide, resource misallocation effects. A narrow-based modern sector was manufactured by siphoning off resources from the rest of the economy. But few benefited from such a development, and the population as a whole remained in poverty. The narrow economic base was also vulnerable to shocks emanating from domestic and foreign sources; such economic development was often found to be unsustainable. Moreover, to add insult to injury, the manufactured modern sector often found itself unable to survive international competition.

Outside the modern sector, economic conditions failed to improve, partly because it was starved of resources. More importantly, the choices of people outside the modern sector often were severely limited by the myriad of discriminatory barriers and regulatory controls established to facilitate the growth of the modern sector.

Incentives Versus Public Programming

The East Asian economies did not seek to reduce poverty through massive transfer programs. Public programs transferring substantial amounts of resources to provide for the poor have had limited success in eliminating or reducing poverty in most economies. Although programs that seek to enhance the productive capacities of the poor—like investments in education and health—and to extend the mobility of resources—like investments in transportation and communication—have proven invaluable. But public provision of many services are seldom efficient and often beset by corruption. The political and financial sustainability of many transfer programs are doubtful. Large-scale transfer programs are often too expensive to be affordable in poor societies, where large sections of the population remain in poverty or near poverty. More focused programs aimed at targeted groups often fail to help the poor because of their limited reach. More importantly, the poor lack political access to mobilize the state for their interests.

People stay in poverty because they do not command sufficient resources for economic well-being; they are deprived of the choice to deploy their meager resources effectively; and they lack the incentives to accumulate more resources over time and pass them on to the next generation. It is useful to think of these resources as taking many forms: human, natural, physical, financial, family, social, and political. From this perspective, helping the poor involves enhancing their command over resources, removing barriers to a more efficient utilization of the resources they have at their disposal, and providing incentives for them to accumulate more resources.

The poor typically have few resources aside from their own, largely unskilled human resources and those of their families and close relatives. In agriculture, they may own small plots of land. For this reason, policies and measures that limit the choices of the poor to deploy their meager resources and apply them to their most productive uses have severe, adverse effects on those in poverty. Consider a poor peasant household. Often, their economic circumstances would improve greatly if they had secure and transferable land ownership rights, credit facilities, insurance to manage risk, access to markets unfettered by state marketing boards, provisions for infrastructure investments in transportation and irrigation systems, and extension services. Although the provision of these services at affordable prices depends on a number of factors, one major stumbling block in developing economies is the high cost imposed by regulatory barriers.

As agricultural productivity grows, surplus agricultural labor has to be absorbed in labor-intensive manufacturing and service enterprises. The cost of starting new enterprises or becoming self-employed depends critically on entry barriers and the regulatory environment. Improved access to education will improve the employment opportunities of rural workers, while transferable rights in land will improve access to credit facilities for setting up new businesses. Significant rural to urban migration can be avoided if nonagricultural rural enterprises could emerge without too many hurdles. The rapid growth in China in the recent reform decade was due to the rise of rural collective enterprises, supported by rural credit cooperatives and a more relaxed regulatory environment.

Migrants who arrive in urban areas will also benefit enormously from a less-regulated environment. Hernando de Soto, in his important study *The Other Path,* clearly shows why the absence of secure property rights and a highly regulated economic environment have suffocated economic growth in Peru. Self-employment and small family businesses in the development process in many East Asian urban economies are not only important for economic growth; these situations have been instrumental in helping poor families increase their income and savings.

Shifting Resumes to Productive Activities

Economic growth in developing nations is to a large extent concerned with shifting resources from less-productive into more-productive activities. Unlike developed nations, economic growth in developing nations are derived primarily from a more efficient allocation of resources, rather than from the development and application of new technologies. Arguments about alleged market failures are therefore less relevant to growth issues in developing nations. The importance of allocative efficiency in promoting growth in developing nations has also been emphasized in a study by Alwyn Young, entitled "Lessons from East Asian NICS: A Contrarian View" (NBER Working Paper No. 4482, 1993). Economic growth and sectoral (or structural) shifts should therefore be more closely related in developing, rather than developed, nations.

Sectoral shifts in employment are often believed to be a source of unemployment. While this may be true, the relationship is likely to be weaker in developing nations, where sectoral employment shifts are associated with greater gains in allocative efficiency that foster faster economic growth and create more and better job opportunities.

Conclusion

While it is generally correct to observe that economic development in poor nations entails shifting resources away from agriculture into manufacturing, and subsequently into services, it is not obvious that this is best done through state intervention. Markets are the preferred mechanism for achieving allocative efficiency, fostering economic growth, and creating employment opportunities. The East Asian experience demonstrates this in the clearest of terms.