○ Presentation (United Nations Development Programme Third Roundtable on Global Change - Change: Social Conflict of Harmony ? Stockholm, Sweden, 22-24 July 1994)

POVERTY, UNEMPLOYMENT AND DEVELOPMENT :

THE EXPERIENCES OF EAST ASIAN ECONOMIES

Yue Chim Richard Wong[1]

Hong Kong Centre for Economic Research
and
School of Economics and Finance
The University of Hong Kong
Tel.: (852) 2547-8313 Fax.: (852) 2548-6319
Email : rycwong@econ.hku.hk

July 1994

[1] Hong Kong Centre for Economic Research and School of Economics and Finance, The University of Hong Kong, Pokfulam Road, Hong Kong, Tel (852) 547-8313, Fax 548-6319.

○ Presentation (United Nations Development Programme Third Roundtable on Global Change - Change: Social Conflict of Harmony ? Stockholm, Sweden, 22-24 July 1994)

POVERTY, UNEMPLOYMENT AND DEVELOPMENT: The Experiences of East Asian Economies

Yue Chim Richard Wong[2]

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 so doing 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, as has frequently happened elsewhere. Most of those interventions were piecemeal in nature and seldom implemented on either a massive scale or 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 interventions 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 with benefits that flow to the few that are 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,

[2] Hong Kong Centre for Economic Research and School of Economics and Finance,

The University of Hong Kong, Pokfulam Road, Hong Kong, Tel (852) 547-8313, Fax 548-6319.

dispersions in income and wealth that result from equal competition in the market place provides incentives for participants to seek to advance oneself and ones family through work and savings, respect for the fruits of others labour, and 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.

Many developing countries try to achieve economic progress by pursuing various grand strategies based on specific goals. These strategies often entailed the adoption of policies that suppress market forces that result in a huge loss of economic efficiency, lower growth rates, and a narrow and precarious economic base that allow 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 labour abundant agricultural economies pursued rapid industrialization through promoting capital intensive industries at the expense of more labour 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 had to 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 manipulating the 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 the 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 e 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 were resisted by denying services to immigrants. Even more draconian and coercive measures were also employed from time to time.

Nevertheless these controls could not always guarantee that resources would voluntarily flow toward the capital intensive industries which the state favoured. 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 were 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, for example, 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 benefitted 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 was often found to be unable to survive international competition.

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

The East Asian economies did not seek to reduce poverty through massive transfer programmes. Public programmes to transfer substantial amounts of resources to provide for the poor have had limited success in eliminating or reducing poverty in most economies. Although programmes 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 to be invaluable. But public provision of many services are seldom efficient and often beset by corruption. The political and financial sustainability of many transfer programmes are doubtful. Large scale transfer programmes are often too expensive to be affordable in a poor society, where large sections of the population are in poverty or near poverty. More focussed programmes aimed at targeted groups often fail to help the poor because of their limited reach. More importantly the poor lack political access to be able 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 meagre resources effectively, and they remain poor because they lack the incentives to accumulate more resources over time and pass them onto 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 limits the choices of the poor to deploy their meagre resources and apply them to their most productive use have severe adverse effects on those in poverty. These barriers take many forms.

Consider a poor peasant household. It is often the case that 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, and provisions for infrastructure investments in transportation and irrigation systems, and extension services. Although the provision of these services at affordable prices depend on a number of factors, one major stumbling block in many developing economies is the high cost imposed by regulatory barriers.

As agricultural productivity grows, surplus agricultural labour have to be absorbed in labour 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 and transferable rights in land will improve access to credit facilities for setting up new businesses. A great deal of rural to urban migration can be avoided if non-agricultural rural enterprises could emerge without having to overcome 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* shows clearly why the absence of secure property rights and a highly regulated economic environment has suffocated economic growth in Peru. The importance of self-employment and small family businesses in the development process in many East Asian urban economies are not only important for economic growth, but has been instrumental in helping poor families increase their income and savings.

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 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, "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 than developed nations.

A simple illustration of this proposition is presented in Table 1, where I regress growth rates of GDP against an index of sectoral employment shifts. Appendix 1 gives definitions of the variables used. The estimated coefficients of the variable indexing the extent of sectoral employment shifts are positive and statistically significant in the samples of data from the East Asian and Non-Japan East Asian economies. They are still positive for the Group of 7 and Group of 6 nations, but are no longer statistically significant. Since growth rates and sectoral employment shifts are both endogenous outcomes, one should not interpret these results as reflecting causal relationships.

Sectoral shifts in employment are often believed to be a source of unemployment. While this may be true in general, 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. In Table 2, I present results that regress unemployment rates against an index of sectoral unemployment shift. They show that the estimated coefficients are positive and statistically significant in the samples of data from the Group of 7 and Group of 6 nations. They are still positive for the East Asian and Non-Japan East Asian economies, but are no longer statistically significant. Again one should not interpret these results as reflecting causal relationships.

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 interventions. Markets are the preferred mechanism for achieving allocative efficiency, fostering economic growth, and creating employment opportunities. The East Asian experience demonstrates that this is the case.

TABLE 1: REGRESSIONS OF GDP GROWTH RATES

	ALL	G7	NJEA	ALL	G6	EA
CONSTANT	10.5905	9.0453	9.6198	9.7726	7.6535	9.3957
	(1.9215)	(1.4464)	(2.3322)	(1.8173)	(0.9105)	(2.272)
SECT EMP SHFT	0.1667	0.0922	0.1892	0.1871	0.0835	0.2115
	(0.0481)	(0.0755)	(0.0666)	(0.0434)	(0.0493)	(0.0607)
TIME	-0.0712	-0.0861	-0.0626	-0.0658	-0.0717	-0.0651
	(0.0345)	(0.0366)	(0.0602)	(0.0324)	(0.0242)	(0.0547)
G7/G6	-3.3314			-3.4802		
	(0.5302)			(0.4830)		
R^2	0.6079	0.2384	0.2631	0.6493	0.3557	0.3147
N	70	35	35	70	30	40

Note: Time trends and G7/G6 dummies are included in the regressions. Parenthesized values are standard errors.

TABLE 2: REGRESSIONS OF UNEMPLOYMENT RATES

	ALL	G7	NJEA	ALL	G6	EA
CONSTANT	-12.9953	-19.7251	-1.9202	-13.3201	-19.8123	1.0137
	(2.251)	(2.2185)	(1.8674)	(1.9618)	(1.6762)	(1.9541)
SECT EMP SHFT	0.1116	0.2378	0.0681	0.1141	0.1774	0.0339
	(0.0642)	(0.1159)	(0.0583)	(0.0527)	(0.0907)	(0.0669)
TIME	0.1930	0.3068	0.0572	0.1956	0.3227	0.0278
	(0.0439)	(0.0562)	(0.0519)	(0.0376)	(0.0446)	(0.0608)
G7/G6	3.0192			3.7265		
	(0.6630)			(0.5440)		
R^2	0.3438	0.4827	0.0571	0.5016	0.6601	0.0126
N	66	35	36	66	30	31

Note: Time trends and G7/G6 dummies are included in the regressions. Parenthesized values are standard errors.

APPENDIX 1: NOTES AND DEFINITIONS

1. Data are obtained for the 1966-91 period. EA denotes the East Asian economies of Hong Kong, Indonesia, Japan, Malaysia, Philippines, Singapore, S. Korea, Taiwan and Thailand. NJEA denotes non-Japan East Asia. G7 denotes Canada, France, Germany, Italy, Japan, U.K., and U.S.A. G6 excludes Japan. Growth rates are real GDP are 5-year annual averages. Unemployment rates are 5-year averages.
2. The index of sectoral employment shift is defined as $\Sigma_i |s_{it} - s_{it'}|/2$ where s_{it} is the employment share of sector i in year t. 1-digit level classifications are used over 5-year intervals.

TABLE 3: INDICES OF CHANGE IN EMPLOYMENT SHARE (%)

Period	66-71	71-76	76-81	81-86	86-91
Canada	9.30	19.10	5.50	8.00	6.30
France	9.20	8.50	8.70	10.00	7.00
Germany	7.70	9.90	8.30	6.10	5.10
Italy	10.43	10.55	18.72	14.60	6.50
U.K.	6.60	9.70	7.90	11.70	7.40
U.S.	8.90	6.40	3.40	7.50	5.20
Japan	12.80	10.70	6.70	5.20	5.20
Hong Kong	3.73	28.64	19.07	10.65	19.59
Indonesia	--	--	13.66	4.28	6.71
S. Korea	20.52	17.73	22.78	22.26	16.45
Malaysia	--	--	20.35	16.69	14.39
Philippines	12.64	8.53	8.16	5.90	9.18
Singapore	20.99	13.02	11.63	14.07	10.11
Taiwan	23.26	15.50	20.85	9.40	14.32
Thailand	--	7.02	7.98	10.57	7.31

Sources: Year Book of Labour Statistics, International Labour Office, various issues; Statistical Yearbook for Asia and the Pacific, United Nations, various issues; Statistical Yearbook of the Republic of China, 1993; Labour Force Statistics, OECD.

- Presentation (United Nations Development Programme Third Roundtable on Global Change - Change: Social Conflict of Harmony ? Stockholm, Sweden, 22-24 July 1994)

TABLE 4: AVERAGE ANNUAL GROWTH RATE (%)

Period	66-71	71-76	76-81	81-86	86-91
Canada	4.39	5.31	3.44	2.82	1.92
France	5.29	3.37	2.52	1.79	2.85
Germany	4.17	2.67	2.23	1.55	3.51
Italy	5.00	4.03	3.61	1.87	2.70
U.K.	2.54	2.19	1.01	3.15	1.99
U.S.	2.49	2.66	2.60	2.76	1.82
Japan	9.94	4.42	4.44	3.66	4.89
Hong Kong	6.75	8.49	10.46	5.93	6.51
Indonesia	6.75	8.02	8.13	4.33	6.46
S. Korea	9.78	9.61	6.29	9.54	9.44
Malaysia	--	8.28	7.62	3.94	8.37
Philippines	5.19	6.67	5.19	-1.28	3.85
Singapore	13.13	8.52	8.99	4.64	8.96
Taiwan	10.55	9.09	9.05	7.79	7.84
Thailand	7.91	6.47	7.33	5.36	10.89

Source: International Financial Statistics, IMF

TABLE 5: AVERAGE UNEMPLOYMENT RATE (%)

Period	66-71	71-76	76-81	81-86	86-91
Canada	4.60	6.18	7.62	10.22	8.63
France	2.32	3.23	5.68	9.02	9.75
Germany	0.92	2.10	3.70	7.05	6.88
Italy	5.47	5.92	7.27	9.40	11.38
U.K.	2.03	3.03	5.72	10.80	8.30
U.S.	4.15	6.25	6.80	7.98	5.93
Japan	1.20	1.53	2.08	2.55	2.43
Hong Kong	--	--	3.88	3.65	1.68
Indonesia	--	--	2.47	2.40	2.65
S. Korea	5.37	4.18	4.07	4.10	2.78
Malaysia	--	6.17	5.52	5.92	7.22
Philippines	6.50	5.07	4.68	6.12	8.27
Singapore	6.97	4.48	3.60	3.67	3.43
Taiwan	2.05	1.69	1.51	2.37	1.85
Thailand	--	0.45	0.82	2.70	3.12

Source: Labour Force Statistics, OECD