Paul Sullivan
GOVT 433
Political Economy of East Asia

Report on Transitional Development in East Asia

Introduction

This paper intends to give a general explanation of the framework of economic development. In doing so, this paper will be divided into two primary sections followed by a conclusion. The 'Factors of Development' section will outline and seek to explain – in my view – the broad factors most important in the transitional development in an economy: Allocation of economic resources, and Economic confidence & political stability. These factors were chosen because many other influences on national economies were predisposed to these former two or are practically outside the scope of state economic influence – such as distribution of natural resources, internal geography, cultural history, etc. In the 'Implementation in East Asia' section, two East Asian economies – the Philippines and Taiwan – will be examined and compared with one-another with the framework established in the prior section at a basis. Finally, the 'Conclusions' section will cover how this framework-theory would indicate an 'economic success' and the limitations this theory has in rendering such an assessment.

Factors of Development

1) Allocation of Economic Resources

All economies have various resources that each can utilize to further its own growth and development. Economic resources in this regard include the tangible primary factors of production – land, labor, capital – and their secondary factor derivatives. An important note is that these resources have a degree of scarcity associated with them. As a result, economic actors at every level within the national economy must contend with having to solve the primary economic problem of ‘having unlimited wants and needs with a scarce allotment of resources’. This relationship is essential to the importance of resource allocation within an economy because it is the basis of comparative advantage. How well an economy goes about utilizing its unique resources to meet both its own demands and the demands of others primarily determines that economy’s growth on the international market.

Economies that allocate their resources poorly and/or those that fail to consider the absolute advantages present on the international market are highly prone to being underdeveloped. Some examples that involve the primary factors of production of this include natural resources that are unutilized; a labor force that is underdeveloped or unemployed; using machinery/technology that is outdated; and financial capital that is statically held. This responsibility falls both governments and entrepreneurs as their shared role is the efficient allocation of their share of scare resources given their respective objectives in the overall economy: the creation of effective commercial goods and services and effective public goods and services.

The state – and by extension its respective bureaucracy – has several roles in terms of allocation of economic resources. Evans (1995) enumerates a set of four roles that describe the various economic functions of the state. Out of those four roles, three involve the state’s allocation of economic resources: husbandry, midwife, and demiurge. The ‘husbandry’ role describes the state’s function of sustaining and assisting *status quo* private industry to better provide for an underdeveloped economic concern. The ‘midwifery’ role describes the state’s role of nurturing latent or non-existing industry as to introduce – or in some cases re-introduce – absent or under-served entrepreneurial groups. The ‘demiurge’ role describes the state’s role and capacity to directly provide for the economic needs of the state either when there is no available means for the private sector to provide for such a need or when the state decides such private sector capacity is insufficient or inadequate.

When state actors abuse these economic roles, the state – in effect – is misallocating economic resources illicitly. This economic misallocation – best described as corruption – can have disastrous effects on the legitimate need and desire for economic growth. Corruption also simultaneously degrades confidence in the economy – a point that will be evaluated more fully in the other important factor of transitional development in my framework. This corruption generates an economic dead weight loss that ends up being paid for by every participant throughout an economy via higher prices on transactions. Furthermore, such corruption creates an absence of utility resulting from the opportunity costs inherent in corrupt dealings. Some examples of these dead weight losses include: the increased prevalence of organized, politically-linked criminal organizations; increased social inequality; and – perhaps most importantly according to Thompson (1993) – the de-legitimization and privatization of civic life.

2) Economic Confidence & Political Stability

Participants within an economy have a tacit expectation of good faith with their governments and their respective economies. When such an expectation is eroded or even broken, people – both domestically and internationally – will be less willing to do business within that given economy due to the fear and uncertainty associated with it. This erosion of faith can originate due to corruption – as described previously – or can come as a result in overly ambitious fiscal policy. This directly results in a dead weight loss being placed on the entirety of that economy which stifles economic growth – transitional development by extension. Conversely, ‘financially responsible' and 'politically stable' economies can expect to see growth purely by virtue of them being stable stores of wealth. This economic reality results in a rather grim feedback loop for countries that have had rocky histories – especially those who have this in combination with a natural deficiency in one of the three major factors of production.

One of the major implications of both economic confidence and political stability is access to foreign direct investments (FDI). These FDIs are often associated with general economic growth and integration into the global economy. Though these FDIs are generally criticized for the mild 'crowding out' effect in the domestic markets, Backer and Sleuwaegen (2003) make the claim that the long-term structural effects between foreign and domestic firms "can moderate or even reverse crowding out effects."

Countries who find themselves with a stagnating economy who are unable to generate capital either domestically or through FDIs are faced with an uncomfortable dilemma: Either play what Krugman (1999) describes as "The Confidence Game" just to receive a loan from the IMF or know for certain that their long-term future will be economically stagnant. This game that Krugman (1999) describes is where said countries – who are already struggling economically speaking – are forced into a situation where they must essentially gamble the future of their economy with the implementation of austerity measures. While this condition is intended to be "perceived by the market as favorable", the recognition of having to go to the IMF has an effect of souring the already low confidence in said country's ability to act economically responsible.

Participants within an economy also expect their government – and by extension the community in which they live – to have a fair degree of political consistency year-on-year in order for the participants to make long term economic decisions. This long-term decision making can't be assured when the government still wrestles with issues such as political extremism, military coups, erratic fiscal or monetary policy, disregard for civil liberties and/or the rule of law, or domestic violence. Such a lack of long-term financial decision making can lead to capital flight or, in extreme cases, brain drain and a reliance on remittances.

One of the conditions that allows for confidence and stability in an economic sense is that the respective government has a precedent of respecting the foundation of free trade. This foundation includes the fourth economic role of the state Evans (1995) writes about that is the 'custodial' role which describes the function of being a regulator and enforcer of the foundational aspects of free trade. This function involves aspects such as property rights, generally free speech, right to self-determination, enforcement of contracts, etc. In addition, Evans (1995) makes a distinction between bureaucracies that are 'predatory' and those that are 'developmental' through the qualities of 'embeddedness', or roughly how familiar bureaucracies are with societal needs, and 'autonomy' or how free and impartial the bureaucracy is to undue influence.

Implementation in East Asia

1) <u>Taiwan</u>

The Republic of China (ROC), or Taiwan, is a relatively sound case-study to the effectiveness of the two-factor economic development framework outlined in this paper. Though relatively fortunate in terms of the potential for human capital both from intellectuals fleeing the mainland and latent Japanese encultured and educated domestic population, the nation still had to contend with a tremendous economic setback given post-WWII construction. In addition, the ROC had to handle the short-term unemployment of roughly 1.6 million mainland KMT refugees (Government Information Office in Taiwan, 2010). Additionally, though semi-industrialized, post-WWII Taiwan was still primarily an agricultural economy with agricultural share of GDP being roughly 32% and industrial share of GDP being roughly 17% in 1952 (Government Information Office in Taiwan, 2010). The economy of Taiwan shortly thereafter made an industrial shift that could be cynically described as 'Import-Substitutive', but a fairer description for the protectionist shift would be one primarily aimed at stabilizing the local economy. The economy at this time primarily exported primary agriculture and textiles.

The economy would eventually cut back on protectionist regulations as a response to the energy crisis in the early 1970s and experience double digit annual GDP growth on average throughout the period between 1963-1980 (Government Information Office in Taiwan, 2010). In 1984, the ROC initiated a wave of political fiscal and monetary liberalization and privatization of ROC SOEs. The industrial sector also shifted its intensity and focus during this period away from the prior labor-intensive industry towards capital, technological-intensive, and heavy chemical industries. These exports would remain roughly the same to the present day (Government Information Office in Taiwan, 2010).

The ROC seemed to realize relatively quickly via their progressive policy shifts that self-reliance and protectionism would not be effective economic strategies. Taiwan seemed to have a solid understanding of its comparative position on the global market through its leveraging of human capital and progression of industry. Furthermore, the ROC demonstrated an effective capacity to perform the roles of the state as described in Evans (1995). In addition economic confidence in the ROC – though somewhat shaky at first and throughout – had enough recognized confidence vested within its economy that it became associated with the other three highest performing economies in East Asia within the ‘Asian Tigers’. This is not to ignore the initial corruption and subsequent political repression of the KMT regime in the events of the ‘228 incident’ and other crackdowns on political dissent until the early-1990s. Furthermore, throughout the Marshal Law period one could argue that a one-party ruled ROC is a rather ‘non-robust’ political framework given that the nation still considered itself ‘at war’ with mainland China. Arguably, this factor of political instability persists to the present day given the present day although at present the prevailing DPP-led ROC seems to be judiciously maintaining *status quo* Cross-Strait Relations.

2) The Philippines

The Philippine government in relation to the ROC maintains a relatively longer economic history. To contain the scope of analysis, I plan to cover the economic history of the post-WWII era from the Third Philippine Republic from 1946 onwards. The Third Philippine Republic had an issue of wealthy rural elites that would contribute to lingering economic inequality. Failure to economically address this issue nor post-WWII under-employment and over-zealous and often counter-intuitive fiscal policy of import-substitution led the nation to experience lackluster economic development for the next 26 years (L., E., 1984) Such lackluster economic performance likely contributed in some way to the prevailing civil unrest and the growing influence of communist guerrilla groups. In 1972, Martial Law was declared under President Ferdinand Marcos with one of his first policies was to transfer land ownership from the rural elite to peasant Filipinos and later provided means to subsidize agricultural costs under a new agricultural system (L., E., 1984). Still, the Marcos regime tried to simultaneously emphasize manufacturing while maintaining protectionist trade policies (L., E., 1984). This had the effect of shifting the economic elite from rural landowners to urban industrialists and businessowners.

This overall mismanagement would result in a rather severe economic crash in the early 1980s which stemmed from severe post-1979 borrowing, the prevalence of unreported, short-term debt, and the overvaluation of the peso (L., E., 1984). The Macros regime would eventually address the crash with substantial set of austerity measures by 1983, which included multiple devaluations of the peso, limitations on foreign loans, and the authorization of total foreign investment in domestic enterprises (L., E., 1984). This would result in the World Bank approving $83 million of financial aid to the Philippines. As a consequence of these austerity measures, the Philippines need to devalue the peso again and began to experience substantial capital flight (L., E., 1984). After much political controversy, President Marcos would flee to Hawaii in 1986 leaving his predecessor President Corazon Aquino an economy that was very much underdeveloped. Subsequent economic growth eventually returned to the Philippines but would develop extremely slowly with annual GNP growth ranging from 6.7% in 1988 to barely over 3% in 1990 (Hays, J., 2015). The Philippine economy under President Fidel Ramos would have limited economic success, but the Philippines would be plunged into the Asian economic crisis near the end of his term in late 1997 (Hays, J., 2015). The trend of slow and consistently low GNP growth would continue into the 21st century under successive Philippine presidents ranging from ~3% - ~7% annual GNP growth (MacroTrends, 2021).

The Philippines seemed to take a very different approach developmentally from the ROC during the post-WWII period. The Philippines seemed to over-emphasize the agricultural sector; seemed indifferent to technological innovation and comparative advantage within global markets; and didn't seem to a good handle of economic resources. While the Philippines seemed to have some elements of the economic roles of the state presented Evans (1995), they were often developed into a viable macroeconomic strategy – only beginning the push towards an export-led economy after the mid-1980s. The deprivation of economic confidence and political stability caused by resource misallocation led to the Philippines playing 'The Confidence Game' described by Krugman (1999) and eventually facing the unfortunate consequences. Overall, economic confidence and political stability in the Philippine economy seems to reflect each-other in an economically bleak manner.

Conclusions

According to my observations of both the ROC and the Philippines regarding the economic growth framework presented in this paper – that a development economic framework that places 'Allocation of Resources' and 'Economic Confidence & Political Stability' as its two most important factors – seems descriptively sound. These observations also seem to indicate that relative importance of these factors shift from the former in early economic development and the latter in late economic development.

What I personally found to be interesting observations were that the framework predicted that export-driven growth would be more economically successful than import-substitution led growth – though this could be due to an implicit preference within the framework itself. I was also surprised by the real-world outcome of 'The Confidence Game' in the case of monetary assistance to the Philippines.

One criticism of this theory is that it is vague enough that the framework itself is less of a proscriptive theory and more of a descriptive theory. Additionally, the condition in this framework for governments to be politically stable in order to maintain a healthy degree of developmental potential ‘political stability’ is not necessarily synonymous with ‘economic health’. Nor is this ‘political stability contingent on a government maintaining a healthy relationship with its citizens (Hussain, Z., 2014). Authoritarian governments, such as the ROC’s early KMT government on Taiwan, had a fair degree of internal political stability and a fairly unremarkable economy.

Paul Sullivan
GOVT 433
Political Economy of East Asia

References:

DE BACKER, K., & SLEUWAEGEN, L. (2003). Does Foreign Direct Investment Crowd Out Domestic Entrepreneurship? *Review of Industrial Organization, 22*(1), 67-84. Retrieved March 26, 2021, from http://www.jstor.org/stable/41799141

Evans, P. (1995). Embedded Autonomy: States and Industrial Transformation. PRINCETON, NEW JERSEY: Princeton University Press. doi:10.2307/j.ctt7t0sr

Government Information Office in Taiwan. (2010). The Story of Taiwan - Economy. https://web.archive.org/web/20100202032138/http:/www.taiwan.com.au/Polieco/History/ROC/report04.html.

Hays, J. (2015). ECONOMIC HISTORY OF THE PHILIPPINES. Facts and Details. http://factsanddetails.com/southeast-asia/Philippines/sub5_6g/entry-3916.html.

Hussain, Z. (2014). *Can political stability hurt economic growth?* World Bank Blogs. https://blogs.worldbank.org/endpovertyinsouthasia/can-political-stability-hurt-economic-growth#:~:text=The%20economy%20may%20do%20well,means%20a%20predictable%20political%20environment.&text=The%20economy%20eventually%20suffers%20because,lead%20to%20higher%20economic%20growth.

Krugman, P. R. (2009). *The return of depression economics and the crisis of 2008.* W.W. Norton & Co.

L., E. (1984). *The Roots of the Philippines' Economic Troubles*. The Heritage Foundation. https://www.heritage.org/asia/report/the-roots-the-philippines-economic-troubles.

MacroTrends (2021). Philippines GNP 1962-2021. https://www.macrotrends.net/countries/PHL/philippines/gnp-gross-nationalproduct#:~:text=Philippines%20gnp%20for%202019%20was,a%203.78%25%20increase%20from%202016.

Zalewski, D. (2000). Political Confidence and Monetary Stability in the Age of Globalization. Journal of Economic Issues, 34(2), 369-375. Retrieved March 26, 2021, from http://www.jstor.org/stable/4227565