Understanding Development Strategy in Southeast Asia

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1. Introduction

In the second half of the 20th century, the inquiry into the causes of and solutions to underdevelopment has centered around the role of government in the economy. This viewpoint has enjoyed strong support among international development specialists, and, since the 1980s, from national officials themselves, at least at the rhetorical level.

This paper will review the development experience of key economies in Southeast Asia and will utilize the government-in-the-economy framework to organize a discussion about the development experience of these countries. This particular development experience portrays an implicit critique of this approach. In this section, we would like to briefly introduce the limitations of a government-centered development analysis.

The fashionable view about the proper role of government has been subject to wide shifts as actual experience in overcoming underdevelopment accumulated, in spite of the fact the government's economic role has always constituted the analytical key.

The start of the period, from the early 1950s, saw an almost unanalyzed belief in the power of governments to make development happen. The social demands arising from especially from the elites of the newly independent nations, combined with technical convictions about economies of scale, multiplier effects, backward and forward linkages led many countries to attempt to implement policies earlier seen in the economies that had followed Britain into industrialization, most particularly Germany in the late 19th century.

These regimes consisted of protection and subsidization of industry, transfer of surpluses from agriculture to industry and the urban areas, and the extensive participation of the state in economic life. In the design of these development policies, considerations about the ideological, class, and cultural bases and capabilities of the key apparatus - the state - remained un-analyzed as far as both theoreticians and practitioners were concerned (just as at the present juncture when development theory now calls for a radically different role for the state, the same factors remain largely outside the analysis). The interventionist industrial approach was tried by both communist and non-
Beginning in the mid-1970s, professional economic analysts began to raise doubts about the activist role of the state in development. Government-operated import-substitution industrial regimes were ultimately identified to be the cause of underdevelopment itself. (See, for example, Krueger [1978].)

At the start of this trend, the principal objections revolved around the (static) efficiency effects of protectionism (deadweight losses due to price wedges, resources diverted from production in order to obtain government privileges - "rent-seeking"). These objections did not prove to be fatal. Empirically, (1) deadweight losses have not tended to be large; and (2) even before professional analysts could give it a name, Korea and Taiwan, in response to foreign exchange shortages, installed industrial regimes that in the net promoted exports as much as substituted against imports, thereby instituting a labor-absorbing growth path.

Eventually, the most important critique of protection and industrial promotion revolved around their incentive effects, both those induced on private behavior and those bred within government agencies and enterprises. These criticisms are taken to apply both to import-substituting and export promoting regimes, the latter being characterized as having grown much faster if only government had not intervened. Government-mandated allocation of resources suspends market discipline and redirects investment towards projects that depend on government support. Because of the suspension of competitive pressures and because good government interventions are those that rely on well-defined rules, government-supported projects tend to be technologically static and import-dependent. The more government, therefore, the less development.

This analytical framework depends on (1) the ability to distinguish for purposes of analysis between private and public economic activities and (2) a view that private actors dominate public agencies in installing sustainable new economic activities.

In the case of the private-public sector distinction, in many developing countries, often as legacy from colonial times, private and public economic activities tend to be highly interspersed. As we shall in the discussion on the second factor, this private-public intermingling can be an indicator of the level of development itself. In such economies, it is not surprising to see private companies providing a significant proportion of social infrastructure while government trading firms and holding companies operate key industries, with neither party able or willing to rapidly switch roles.

Moreover, the political and social structure through which private interests of elite groups are translated into government action and vice-versa, makes it difficult to differentiate the public from the private interest, even though it may still be possible to distinguish between the elite and non-elite interests. When elites are sufficiently unified and internalize the national interest, national development (though not
necessarily the improvement in the general standard of living) can occur even with extensive government.

In the case of the relative capacities of private and public organizations, because of long traditions of civil service (in East Asia particularly) or as an indication of the level of development itself, state agencies can dominate the private sector in terms of planning and execution capability. Over the medium and long-term, the flexibility of private organizations will still prove to be advantageous, but it still begs the question of how does the state, since it is supposed to be the analytical key,\(^2\) build up the "private sector." In many Asian economies, the question is one of the role of Singaporean "government-linked companies," Korean chaebols, Indonesian and Philippine crony enterprises, quasi-private (quasi-public) town and village enterprises in China, and ruling party-affiliated enterprises in Malaysia.

The issue goes beyond the famous hard versus soft budget constraint, because in many countries and as marketization proceeds, private credit markets can actually offer the softest budget constraint to their borrowers, even absent the effect of corruption, political connection, and state influence. Episodes of excessive private risk taking, speculation and greed, inabilitys and inadequacies in credit and project appraisal, and the uncontrolability of overall macroeconomic risk itself have been commonplace in developing countries and in countries that abruptly find themselves in transition away from command economies.

Empirical tests of the government-as-development-impediment proposition have been indirect, relying on the examination of the relationship between performance (as measured by output growth or the growth in total factor productivity) against indices of government intervention (indices of trade protection, exchange rate premia, public consumption and investment spending, and so on). Empirical studies have supported the general proposition (for example, Dollar [1991] and Thomas and Wang [1992]). These indirect tests do not take into account the intervening variables (such as bureaucratic capacity) so that results are contaminated by biases from the "missing variables" problem.

Keeping these limitations in mind, the analysis that we shall present in this paper will focus on government policies, but will try to shy away from viewing success or failure as arising from either correct or mistaken policies. The Southeast Asian experience does not provide a neat demonology with respect to government policies, just as the case of East Asia or Singapore do not. In East Asia or Singapore, it has been suggested that government intervention did not cause permanent damage because of effective bureaucracy (Wade [1990]); this factor is more difficult to implicate in the countries in Southeast Asia, with their weaker bureaucracies.

This survey of development policies will take a look at three policy issues: (1) macroeconomic management, (2) trade and industrial policies, and (3) government related enterprises; we will focus on three Southeast Asian countries: Indonesia, Malaysia, and Thailand. The experiences of two other Southeast Asian countries, Singapore and the
Philippines, can be viewed as relative outliers in relation to the Southeast Asian experience and will be called upon to illustrate contrasts where helpful.

The Southeast Asian economies have been the fastest growing set of countries in the early 1990s (a period, which as we shall see, the countries themselves look upon as a time of emerging from dangerous waters). The interpretation of the Southeast Asian experience will have to take into account that their more sustained rate of growth. The three successful Southeast Asian economies have not only grown faster than other country groupings before 1980, they have also managed to grow, albeit at a slower pace, in the decade of the 1980s (Table 1). Our review will carefully identify government policies before and after the 1980s.

2. Macroeconomic Management and Capital Inflows

The ultimate test of successful macroeconomic management is the maintenance of an orderly relationship with a country's foreign creditors. The iron law of macroeconomic spending balances states that the current account deficit is identical to the sum of the fiscal deficit and the domestic savings deficit; the current account deficit is, in turn, commensurate with the rate at which a country's external liabilities are accumulating. Macroeconomic management is directly concerned with fiscal balances and investment balances. On the basis of this ultimate test, the countries in Southeast Asia have been quite successful in the area of macroeconomic management, with the notable exception of the Philippines.

The success is not however due to "conservative macroeconomic management" among all the countries, except for Thailand. Other countries in the region have clearly 'lived more dangerously' in macroeconomic terms. In this section, we will see that "conservative management" has to be understood more in quantitative, relative terms.

Indonesia

Indonesia has managed its fiscal affairs on a "balanced budget" system since after 1965 when the Inter-Governmental Group on Indonesia (IGGI) was formed to manage external assistance to the country. In legal terms, the balanced budget system prohibited the financing of the budget deficit by domestic means - either from debt or money creation. In practice, the balanced budget approach meant that before every fiscal year, Indonesian authorities identified the sources of financing for the government deficit from a negotiated level of external assistance.

Sharp cutbacks (or postponements) of government projects exemplified the stabilization program implemented by the New Order government after the replacement of the Sukarno government. The
government has had occasion to fall back on this tool in subsequent crises.

Oil revenues have been a significant proportion (as much as 70 percent of budget revenues) of Indonesia's government revenue and a source of volatility as international oil prices have risen or fallen. Until the crisis of its premier oil company, Pertamina, the use of oil revenues were not fully controlled on macroeconomic grounds; instead, these were directly invested in development projects. Thus, during the oil boom in the 1970s, many analysts had characterized Indonesia as succumbing to Dutch disease, investing windfall earnings in unsustainable projects and subsidizing domestic consumption. Nevertheless, the existence of oil exports were responsible for the low (relative to other developing countries) current account deficits; between 1970 and 1982, Indonesia's current account deficit did not exceed 2 percent. By the end of the 1970s, public expenditure cutting efforts had brought Indonesia's investment and public spending under control so that it actually had a current account surplus of 2.7 percent of GNP in 1980.

Indonesia's macroeconomic management entered its most critical test in the 1980s, as a result of the sharp fall in oil prices and the sharp depreciation of the U.S. dollar. Because the rupiah was pegged to the dollar, the decline in the value of the dollar meant that its non-dollar external liabilities, especially those denominated in yen, had multiplied overnight. The source of the shocks were therefore external and substantial; Bhattacharya and Pangestu [1992, p. 14] report an estimate of the shock as high as 15 percent of GDP. In 1982, Indonesia's current account deficit had reached almost 8 percent of GDP.

Indonesia's addressed the 1980s crisis by once again cutting back public expenditure sharply and implementing a wide range of measures liberalizing industrial policy. These measures included the encouragement of foreign investment for export-oriented activities; Indonesia thus managed to turn the adversity from the currency realignments to opportunity by welcoming the relocation of labor-intensive manufacturing firms from Japan, Korea, and Taiwan. Non-oil exports responded with growth rates of that averaged 13 percent per year between 1983 and 1990. The share of manufactured exports rose from 12 percent of total exports in 1985 to 45 percent in 1991, and now contribute more than either oil or primary commodities exports.

Malaysia

Like Indonesia, Malaysia joined the ranks of independent nations (in 1957) as a strong exporter of primary commodities, especially rubber, and oil. Like Indonesia, Malaysia has pursued a policy of state and state-spurred, investment to diversify its economy from its colonial structure. As a ratio to GDP, Malaysia had larger current account deficits than Indonesia, running at 3.3 percent in 1970-75, turning positive at 2.9 percent in 1976-78 as a result of oil price increases, and turning sharply negative again at -5.8 percent in 1979-82 and -6.6 percent in 1983-85. These numbers indicate a pro-development stance
which must be reconciled with periodic crises as a result of swings in commodity prices.

Nevertheless, Malaysia's external financing problems are a phenomenon of the 1980s when Malaysia began to borrow heavily from private commercial sources. Before the 1980s, most of Malaysia's external financing came from project loans from multilateral and bilateral sources (Jomo [1993, p. 178]). Initially, the loans were made to ride out the world recession in the early 1980s; eventually, borrowing was used to finance major industrial projects. Many of the loans were denominated in yen, inducing intense pressure in the second half of the 1980s as the yen appreciated. As late as 1988, Malaysia's resource gap represented 10.8 percent of GDP.

Inflows of foreign investment helped to ease the external payments pressure, as Taiwanese and Korean investors moved many of their operations in electrical and electronic industries. Malaysia used the resources to begin prepaying its external loans. The resource gap fell to 4.3 percent of GDP in 1989 and has stayed below 3 percent thereafter. Malaysia's external debt hovers around 8 percent of exports. It might be said that Malaysia has successfully traversed a difficult macroeconomic period, with a few heavy industries in place and with a relatively light debt burden, quite in contrast with the experiences of debt-distressed countries in the same period.

Thailand

Thailand has managed an average rate of growth of 7.5 percent in the last three decades and is the country with the strongest reputation in macroeconomic management among the countries in the region. "Monetary policy has been directed primarily at maintaining price stability goals, rather than promoting growth" (Chewakrengkai [1993, p. 6]). On the conviction that devaluing the currency will cause domestic inflation, Thai authorities have also paid attention to current account deficits in determining monetary and fiscal policy. The Thai stance was distinguished in that government officials did not consider it primary responsibility to raise foreign financing to cover current account balances in order to, for example, defend the exchange rate (as they had in the Philippines); instead, they sought to use tools within their scope of control, such as fiscal deficits and monetary creation, to set the current account balance to be consistent with a fixed exchange rate.

The extraordinary Thai stance with respect to foreign financing has been traced to government consciousness about the importance of retaining the country's economic independence (Christensen, et. al. [1992]), with historical roots in Thailand's resistance to encroachment on its sovereignty by Western colonial powers beginning in the late 19th century. It has manifested itself in Thai reticence, at the expense of causing irritation among the staff of multilateral agencies, at borrowing even from official sources.
Thailand's most difficult period of adjustment, exceeding that of the two oil crises in the 1970s, occurred in the beginning of the 1980s. Severe declines in commodity prices translated into a sharp slowdown in the economic growth, to a low of 4.7 percent in 1985. Before this, the current account deficit had reached 8.1 percent of GDP, and for the first time the debt service ratio exceeded the target of 20 percent at 21.9 percent.

Thailand carried out a wide ranging program of fiscal and monetary restraint and price adjustments. Thailand devalued the baht, raised domestic prices of energy, removed interest rate ceilings on deposits and attempted (not as successfully) to improve its tax performance. The combination of these policies permitted Thailand to regain its macro-equilibrium and poised it to take advantage of the direct investment flows that occurred in the the late 1980s. Thus, in contrast to Indonesia and Malaysia, where these investment flows provided a "lifeboat" from a difficult situation, Thailand's economy had been stabilized, and re-poised to grow moderately and safely when the new surge of external capital became available.

3. Trade and Industrial Regimes

The system of exchange controls, cascading tariffs, multiple exchange rates, tax incentives and subsidies have lain at the heart of industrial policy for the Southeast Asian countries. These interventions are distinguished from other government economic encroachments in that these are sectorally targetted (even though the intended targets are not often the final beneficiaries). These interventions are implemented through tariff exemptions on imported equipment, tax holidays, preferential exchange rates, import control of competing final goods or key intermediate inputs, restrictions of entry of new capacity in the industry, preferential interest rates and access to credit. These interventions were extensively applied in Indonesia, Malaysia, and Thailand. In the operation of these programs, industrial targetting and boards of investments played a critical role, even though in earlier periods, central banks, through the allocation of import allocations, had taken the lead role in industrial policy.

Indonesia

After the overthrow of Sukarno government, the new government embarked on an extensive reform of trade and customs regulation. The government abolished the import licensing system and for most items tariff rates were reduced. These reforms were carried out in conjunction with the removal of price controls on most commodities.

The New Order government of Indonesia began a broad program of industrial promotion after 1971, with tariff and non-tariff protection of selected products. Non-tariff barriers were particularly biting, evolving into an extensive system of "approved importer" licenses by
1983. The objective was to push import-substitution "upstream" into basic goods like chemicals, synthetic fibers, fertilizer, iron and steel, and cement.

Indonesia's sectoral interventions found its greatest expression in the system of credit ceilings that annually specified how much credit banks can provide for different types of projects.

The initial response of the Department of Trade to the 1983 crisis when lower prices of competing products from abroad threatened protected companies was to restrict import licensing even further. Programs to increase the local content of different assembly activities (initially covering motor vehicles, tractors, diesel engines, and motorcycles, later expanded to construction equipment, diesel engines, homes appliances, and electronic goods (Bhattacharya and Pangestu [1992, p. 34])) were intensified. Table 3 provides evidence that as late as 1990, protection heavily favored basic and capital goods industries, and import-competing industries. While it is clear from the data that protection is declining, through most of the period under review, Indonesia appears to have enjoyed an unquestionably protectionist industrial policy more stringent than in most other countries. In the subsequent section on public enterprises, we shall indicate that the protectionist stance is needed to maintain the viability of many state-owned companies.

In 1988, Indonesia embarked on another trade liberalization effort to rival that in the late 1960s. The objectives of the current program are wide ranging, though at this writing most of the efforts are focused on the evaluation of the current system of protection and the planning of reform implementation.

Malaysia

Between 1957 and 1970, Malaysian sectoral intervention were concentrated in infrastructure development and in agriculture (Salleh et al. [1992]). The government could not pursue a standard protectionist industrial policy because that would have been in conflict with the economic interests of the export plantation sector. A key member of the ruling coalition of parties was the Chinese political party, whose supporters had strong economic roots in trading and light manufacturing. Industrial policy in this period consisted of providing incentives to the private sector in the form of tax holidays, the construction of industrial estates, and the provision of basic infrastructure.

Racially-ignited riots in 1969 changed the stance of the government with respect to the economy. A principal tool for the redress of income inequality took the form of government enterprises in all key areas of the economy, holding stock on behalf of the Malay population (the Bumiputera group) and providing financing for proposed projects from Bumiputera bureaucrats and businessmen. The government set the target of attaining within 20 years 30 percent ownership by Bumiputeras of commercial and industrial categories and employment in all sectors and levels to conform with the country's ethnic composition.
Foreign enterprises were especially subject to nationalization. This opened the way toward an import-substitution stance, to replace the export-oriented policy. In any case, state intervention also paid sufficient attention to providing incentives to certain key export industries. State intervention paved the way for the extensive relocation of U.S. semiconductor companies to Malaysia, exploiting the country's supply of low-cost, semi-skilled female labor. The net effect of these interventions, large though they were in absolute dollar amounts, involved an economy whose degree of price distortion did not differ significantly from that in the Philippines or Korea in 1975 (Salleh et. al. [1992, p. 20]).

In the 1980s, Malaysia began a heavy industrialization push, akin to that undertaken by Korea in 1970, substituting against capital goods imports. Iron and steel, machinery and equipment manufacturing, transport equipment, petrochemicals were among the industries slated for rapid development. Public deficits and public debt exploded, just at the time that the worldwide recession had reduced commodity prices and turned Malaysia's terms of trade against it. This forced the government to reconsider its reliance on the public sector, and attempt a series of privatization and liberalization policies beginning in 1986, with the Promotion of Investments Act, with the expectation that the private sector would undertake the industrialization program.

These policies, just as in Indonesia, fortuitously coincided with the industrial restructuring Japan and the newly industrializing economies (NIEs) began to undergo as a result of the currency realignments. By 1987, positive benefits from the new approach were being felt, with private sector investment growing by at least 10 percent.

**Thailand**

Thailand's strict and orderly macroeconomic management contrasts sharply with its byzantine, "poorly coordinated sectoral interventions" (Christensen et. al. [1992]). Thailand has maintained and continues to maintain significant import protection for selected industries. Among the most highly favored sectors were textiles, automobiles, and pharmaceuticals. Incentives provided by the board of investment included import bans and surcharges on competing imports and exemption from import duties on machinery and raw materials.

As in other countries, industrial promotion benefited capital-intensive manufactures (in defiance of the country's static comparative advantage as a resource-rich, labor-abundant economy). Industrial policy discriminated against agriculture, especially through export taxes. Thai industrial policy was particularly heavy handed in the 1970s when there was an increase in the proportion of heavy industries in manufacturing increased from 32 to 43 percent (Table 2). The result is a an industrial structure heavily skewed toward heavy industries.

In 1981, the threat of the international debt crisis and the fall in commodity prices induced by the world recession exposed the
vulnerability of the economy. Industrial policy shifted to export promotion. The government devalued the currency, removed most export taxes, and reformed the tariff system (reducing the highest rates from 100 percent to 60 percent). Even by the mid-80s, Thailand's effective protection for manufacturing at 52 percent was still higher than Korea (28 percent), Malaysia (23 percent), and the Philippines (23 percent). It was only in 1991, with a more comprehensive liberalization strategy and a strong trend in manufactured exports underway fueled by foreign investment did Thailand significantly reduce its sectoral interventions.

4. Government Related Enterprises

Direct participation of the government in the economy through government enterprises has had a considerable effect on development performance of Indonesia, Malaysia, and Thailand during most of their development experience. The costs of these interventions are measurable in conventional terms: their budget allocations, high prices for domestic users of their output, and slow technical development. (This record contrasts sharply with that of Singapore.) It is not clear whether the benefits of public enterprise weigh more heavily in human resource development, the maintenance of political stability by augmenting the incomes of key political actors, or in conventional terms of enhancing industrialization prospects through economic linkages.

Indonesia

Indonesia's purposes with regard to the establishment of public enterprises coincided with justifications used by other countries. These companies were supposed to contribute to national development, especially in the area of public utility provision, to complement and support private enterprises in related economic areas, and to make profits and contribute to government revenues. Government participation is prominent in oil and natural gas, utilities, steel, aluminum, fertilizer, cement, sugar refining, transportation and communications. Based only on the centrally owned enterprises, the public sector accounted for two-thirds of Indonesia's GDP in 1986-87 (Naya and James [1989, p.46]).

The sharp rise in the number of public enterprises in Indonesia occurred in the 1970s and early 1980s, financed through expanding oil revenues. By the mid-1980s, there was a complex system of control which had accompanied their proliferation; supervision was spread over 14 ministries. There were uncounted provincial and local public enterprises and there were 214 centrally-owned companies (Bhattacharya and Pangestu [1992, p. 36]). During the balance of payments in this period, the weaknesses of public enterprises became conspicuous. Since many of these enterprises were oriented toward the domestic economy and import-dependent, they sustained large losses when the currency was devalued. These companies had long enjoyed protected prices in the domestic and were particularly vulnerable when import restrictions were liberalized.
Indonesia's efforts at trade reform in the mid-1980s therefore created enormous pressures on the fiscal budget and provided the initial impetus to considering a privatization program. Privatization has not proceeded rapidly. In practice, the forceful policy has been that of deregulation and the removal of trade restrictions itself. These policies have forced state firms to begin responding to market costs.

Indonesia's most notable deregulation has been the removal of interest ceilings in the financial sector, the easing of the system of credit allocation, and after 1988 removal of entry restrictions. The reforms originally sparked a significant expansion in the banking system and private banks began competing for deposits. The deregulation process has turned "rocky" since, as private banks found themselves overextended when the central bank attempted to restrict credit expansion. Significant problems of insolvency in specific banks have emerged and authorities have sought to contain their influence on the rest of the financial system, by encouraging mergers or takeovers.

Malaysia

Malaysia's public enterprise policy is heavily conditioned by its New Economic Policy (NEP) redistribute economic access and power to indigenous Malays. In order to meet these objectives, the government began to own and operate banks, hotels, agricultural milling companies, office blocks, factories, and plantations. Like Indonesia, the external crisis in the mid-80s brought privatization issues to the fore. Like Indonesia, the shift in policy direction occurs more as an end to progressive nationalization. Otherwise "privatization has been undertaken on an ad hoc basis" (Naya and James [1989, p. 47]).

In most recent years, Malaysia has begun considering privatization in areas attempted only in industrial economies. Malaysia is looking into privatizing the postal service, the railway system, and even the sewerage system in Kuala Lumpur. The government has retained public control in areas considered critical to industrialization: chemicals, automobiles, foundry, iron, and steel. The government has taken the position that to let these enterprises collapse will only worsen unemployment and slow growth.

In the mid-1990s therefore Malaysia provides an interesting mix of large government enterprises mainly serving the domestic market operating along with private companies, many with foreign participation, and flourishing in the world markets.

Thailand

The economic participation of public enterprises in Thailand is not as extensive as in Indonesia or Malaysia. Nevertheless, these enterprises are important in the economy and are found in a wide array of enterprises, including in some consumer products. In 1986, deficits of state-owned enterprises represented $1.7 billion, or about 3.5 percent of
GDP; more than two-thirds of Thai external public debt arose from public enterprise borrowing (Naya and James [1989, p. 21]).

Thailand has been implementing a policy of partial divestment and deregulation. In the case of electricity generation, Thailand abolished the monopoly of the Electricity Generating Authority of Thailand (EGAT). The government divested itself of part of its holding of Thai Airways International, Erawan Hotel, and the North East Jute Mill.

Privatization efforts have met with resistance from trade unions in public enterprises whose members number to a quarter of a million (the latter itself being an indicator of the importance of the public enterprise sector). As in many other privatization efforts, there has been a problem in attracting private investors to buy government companies.

5. Conclusion

Overall, the Southeast Asian record, as interpreted here, does not fit into the neat government versus market dichotomies; neither does the experience fit into effective government versus ineffective government categories.

It is certainly possible to interpret the record as progressive marketization, emphasizing the long-term trend. This interpretation does not explain the stark difference in performance between the three Southeast Asian countries and other developing countries who share in this feature. This interpretation also ignores the liberalization-intervention cycles that we have seen in Malaysia and Indonesia.

It is also possible to emphasize the role of technocrats in Southeast Asia to put some credence into the effective government hypothesis. In the case the Thailand, as we have pointed out, conservative macroeconomic management has indeed been associated with safeguarding national sovereignty. But, as we have seen, in the Southeast Asian economies state power to intervene has depended less on coercive political power but on the availability of export surpluses (which have been subject to the volatile swings in commodity prices). Technocratic influence has tended to decline just when government power to intervene is strongest.

In Indonesia and Thailand, a self-conscious technocratic coterie has been described to have taken advantage of crisis episodes to dismantle interventionist policies; they have also had occasion to point to the demands of the staff of the multilateral agencies for a "return" to the correct policies in exchange for financing. Based on our narrative, "pruning" would be a better description than the dismantling of state intervention; technocrats in both countries have had to operate in a social milieu where they also must reaffirm that their national identity precedes their technical identity.

Moreover, to confuse the technocratic group with the state and then to characterize the state's behavior as technocratic in the neoclassical
sense is to engage in sophistry (i.e. a weak or even invalid argument that appears powerful because by its structure it is self-confirming). The dominant actors in the successful Southeast Asian states have come from the military (important in both Indonesia and Thailand), party elite (the party alignments showing more stability in Malaysia than in the Philippines), business elite, and the technocrats. That labor or consumers are not part of the list also helps to explain the relative ease by which the costs of adjustment have been distributed, in contrast to experiences in Latin America; it also helps to point to social challenges that are becoming critical in policy design in the successful Southeast Asian countries.

Thus, the general development pattern has been that in periods of financing availability, the governments of these three countries have intervened as extensively as those in many other developing countries. Even in times of incipient crisis as in the early 1980s, Indonesia and Malaysia have initially reacted in the manner that many Latin American states did: intensifying industrial intervention and tightening import restrictions. It is in the instances of macroeconomic crisis that the record of Indonesia, Malaysia, and Thailand differs dramatically from that of other developing countries.

One common thread is that (so far) all three successful Southeast Asian countries have met the periodic and unavoidable macroeconomic crises with a more orderly withdrawal. This has permitted more of the capital and the trained labor — admittedly built-up under inefficient circumstances in the neoclassical sense — to continue to play some economic role after adjustment. There is less in the way of precipitous policy actions, such as we have seen in the Philippines and other debt-distressed economies in the 1980s. As the discussion in government-related enterprises has revealed, public enterprises have been a significant element in the economy. But the macroeconomic adjustment programs did not lead to widespread bankruptcies, while state divestment has been rather limited.

These three countries have had access to more adjustment finance than have other countries in similar situations. Part of the explanation for this is undoubtedly a combination of greater state credibility and negotiating savvy. During the period under review, Cold War considerations, as they did also in the case of Korea and Taiwan played a role; the fact that Indonesia and Malaysia were important alternative sources of oil from the point of view of Japan was also a factor.

Again, the contrast with the Philippines' 1983-85 adjustment in the case of all these different factors is instructive. The Philippines was itself an important Cold War outpost, and for most of the 1970s its government profited from a generous credibility in the eyes of multilateral finance agencies and private commercial banks. However, in the 1983-85 crisis, adjustment financing had to be arranged at the same time that a strong political challenge, which ultimately succeeded, was being mounted against the Marcos government, a government that had been heavily supported by external donors. In that kind of situation, issues of government versus market, meeting program targets versus evading them, took on heavy conflictual overtones, just as they often do in the
relationship of other debt-distressed countries with the staff of multilateral finance agencies.

This review has also indicated the extent to which Indonesia and Malaysia were also "saved" by the influx of private direct investment near the end of the 1980s after both countries had spent the first part of the decade (in an atmosphere of world recession, debt crisis, and depressed oil prices) significantly buttressing their protectionist barriers. This development at least raises doubts about the proposition that countries have to have relatively undistorted industrial regimes to attract export-oriented investment. Indeed, Korea and Taiwan had shown the way before, through their export promotion and export zone strategies and it was their investors that moved decisively into these two countries.5

A second important factor we would like to suggest is that during the crisis periods the mix of relying on price adjustment versus flows adjustment weighed more heavily on the latter at the beginning of the adjustment tending toward the former as the positive outcomes of the adjustment begin to be felt. What we mean by flow adjustment are adjustments in government spending, administrative measures that affect government revenues, rescheduling of payments, and so on, while price adjustments have to do with exchange rate adjustments, interest rate changes, increases in prices on government-provided or subsidized goods.

There are advantages and disadvantages in respect to which adjustments are made first. The advantage of strong price adjustments first is that it immediately liberates private forces to begin to respond with supply to the new prices. If, for example, the protectionist regime penalizes agricultural exports, devaluation will permit these exports to begin to respond. The disadvantage of initiating adjustment through price is that the supply response might be weak because of physical limitations that can only be relaxed over time or because the price changes themselves inhibit a supply response. During the 1984-85 Philippine adjustment, high, government-offered interest rates, eliminated export packing credits (Montes [1985]), except at loss-making prices.

The availability of more adjustment finance played a role in the possibility of greater initial reliance on flow adjustment. It permitted governments to cut back on its expenditures, while retaining sufficient financing for imports needed to keep incomes from deteriorating. Government did not have to rely on the exchange rate to interrupt (or disrupt) imports.

The counter-argument is that, as was exactly the case in the Southeast Asian countries themselves during non-crisis periods, more financing often means less adjustment, or at least more distortion. Here we move into the socio-political theory or model underlying development policy (and the interpretation of development experience). This political theory holds, first of all, that crisis periods are opportunities to get development on the "right track" of investment undertaken in accordance with world prices. According to this model, the resistance to efficiency (and by implication, development) is so
overwhelming that episodes of crisis are windows of political opportunity to overcome these objections.

We would like to suggest an alternative, more inclusive, interpretation of the successful Southeast Asian experience, an experience which has not seemed to have hewn closely to the "right track" of efficient investment, at least in terms of the behavior of the respective governments. Crisis periods have forced these countries to discard the most costly of government interventions, through cutbacks in government spending while protecting the continued development (and some adjustment) of those projects whose fruition are expected in the future.

Politics undoubtedly played a large part in the choice of which projects were to fail and adjustments had be made within the political structure to distribute the costs; this process did not have serious political implications as it did in the Philippines' 1983-85 adjustment program. The successful Southeast Asian countries have managed to avoid dealing with their macroeconomic crises through widespread bankruptcies, even while carrying out some reorientation of their trade regimes.

The advantage of this approach is that it avoids drastic changes in expectations on the part of the private sector about development strategy. Thus, the crisis is overcome without much disruption in the state-business relations. Through the development process, the state continues to accept a coordinating responsibility in "developing the productive forces" (to use a Marxist phraseology). This responsibility is quite different from an alternative view in which the state's main duty in the development process is the renunciation of all forms of inefficiency.

A development approach that places great stress on avoiding disruptive private-public sector relations is a cornerstone of the Southeast Asian model and we have come full circle to the private-public sector argument. The Southeast Asian experience differs notably from the conventional neoclassical development model in that extensive and evidently inefficient participation of the state in development appears not have to inflicted permanent damage.

It also differs significantly from the East Asian or the Singaporean experience in which the state played a distinctly dominant and leading role. In the Southeast Asian case, the state played a successful role in managing macroeconomic balances, including the relationship with official creditors, to protect the private sector from drastic changes in the policy environment. The state used the resources under its control to favor chosen industries and particular business groups. The ethnic aspect of development policy, especially in Malaysia and Indonesia, the close relationship between large business conglomerates and high officials in a relatively stable political environment summoned the state undertake this role.

Inspite of the state's economic participation, the danger was not that of a predatory state, enlarging its control at the expense of the private sector. Because of the strong position of the private sector, what the Southeast Asian economies had to guard against was the danger of a predatory private sector, perverting social intervention for purely
private gain. The Philippines with a more competitive political environment did not escape falling into this trap. While there are no ironclad guarantees, the successful Southeast Asian countries have avoided these costs through periodic reform episodes that reaffirmed the overall development strategy.
References


Salleh, Ismail, Yeah Kim Leng, and Saha Meyanathan. "Growth, Equity, and Structural Transformation in Malaysia: Role of the Public Sector." Paper prepared for the World Bank Workshop on the Role of

Table 1
Growth Performance Among Developing Countries

<table>
<thead>
<tr>
<th>Region</th>
<th>1965-80</th>
<th>1980-90</th>
</tr>
</thead>
<tbody>
<tr>
<td>East Asia and Pacific</td>
<td>5.1</td>
<td>6.2</td>
</tr>
<tr>
<td>South Asia</td>
<td>1.2</td>
<td>3.0</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>1.5</td>
<td>-1.0</td>
</tr>
<tr>
<td>EMENA</td>
<td>3.9</td>
<td>-2.6</td>
</tr>
<tr>
<td>LAC</td>
<td>3.5</td>
<td>-0.5</td>
</tr>
<tr>
<td>Low- and middle-income countries</td>
<td>3.6</td>
<td>1.2</td>
</tr>
</tbody>
</table>

Selected East-Asian Countries

<table>
<thead>
<tr>
<th>Country</th>
<th>1965-80</th>
<th>1980-90</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>4.6</td>
<td>8.1</td>
</tr>
<tr>
<td>Indonesia</td>
<td>4.6</td>
<td>3.7</td>
</tr>
<tr>
<td>Korea</td>
<td>7.9</td>
<td>8.6</td>
</tr>
<tr>
<td>Malaysia</td>
<td>4.9</td>
<td>2.6</td>
</tr>
<tr>
<td>Thailand</td>
<td>4.4</td>
<td>5.8</td>
</tr>
</tbody>
</table>

Source: Thomas and Wang [1992], Table 2.
<table>
<thead>
<tr>
<th>Industry</th>
<th>1970</th>
<th>1979</th>
<th>1986</th>
</tr>
</thead>
<tbody>
<tr>
<td>Heavy Industries</td>
<td>31.9</td>
<td>42.6</td>
<td>36.7</td>
</tr>
<tr>
<td>High-Skill Labor-intensive</td>
<td>9.7</td>
<td>11.1</td>
<td>13.8</td>
</tr>
<tr>
<td>Traditional Light Industries</td>
<td>19.2</td>
<td>20.1</td>
<td>23.3</td>
</tr>
<tr>
<td>Food and Related Industries</td>
<td>39.3</td>
<td>26.2</td>
<td>26.0</td>
</tr>
</tbody>
</table>

**Source:** Christensen et al., [1992], Table 2.
Table 3  
Indonesia: Effective Rates of Protection in Manufacturing  

<table>
<thead>
<tr>
<th>Industry</th>
<th>1975</th>
<th>1987</th>
<th>1990</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Basic Industries</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-oil</td>
<td>-</td>
<td>-1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>Oil refining</td>
<td>-</td>
<td>-1.0</td>
<td>-1.0</td>
</tr>
<tr>
<td>Iron and steel</td>
<td>18.2</td>
<td>13.0</td>
<td>10.0</td>
</tr>
<tr>
<td>Chemicals</td>
<td>28.4</td>
<td>14.0</td>
<td>13.0</td>
</tr>
<tr>
<td>Cement</td>
<td>63.6</td>
<td>60.2</td>
<td>53.6</td>
</tr>
<tr>
<td><strong>Capital Goods Industries</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Engineering goods</td>
<td>-</td>
<td>152.0</td>
<td>139.0</td>
</tr>
<tr>
<td><strong>Intermediate Goods Industries</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wood and cork products</td>
<td>-1.2</td>
<td>25.0</td>
<td>33.0</td>
</tr>
<tr>
<td>Rubber and plastic products</td>
<td>426.0</td>
<td>87.0</td>
<td>64.6</td>
</tr>
<tr>
<td><strong>Consumer Goods Industries</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Food, beverages and tobacco</td>
<td>336.2</td>
<td>122.0</td>
<td>124.0</td>
</tr>
<tr>
<td>Paper and paper products</td>
<td>87.3</td>
<td>31.0</td>
<td>20.0</td>
</tr>
<tr>
<td>Textiles, cloth and footwear</td>
<td>231.8</td>
<td>102.0</td>
<td>35.0</td>
</tr>
<tr>
<td><strong>All Manufacturing</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(excluding oil refining)</td>
<td>74.1</td>
<td>68.0</td>
<td>59.0</td>
</tr>
<tr>
<td><strong>All Tradeables</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(excluding oil products)</td>
<td>29.7</td>
<td>26.0</td>
<td>24.0</td>
</tr>
<tr>
<td><strong>IMPORT-COMPETING PRODUCTS</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>EXPORT-COMPETING PRODUCTS</td>
<td>61.0</td>
<td>39.0</td>
<td>35.0</td>
</tr>
<tr>
<td></td>
<td>-6.0</td>
<td>-2.0</td>
<td>-1.0</td>
</tr>
</tbody>
</table>

Source: Bhattacharya and Mari Pangestu [1992], Table 12, p. 43.
ENDNOTES

1For example in the Philippines, 50 percent of secondary education and 85 percent of college education is privately supplied and demanded.

2A less state-centered analytical framework will tend to directly examine the interests and pressures through which these kinds of organizations emerge.

3Christensen, et. al. [1991], p. 18.

4The qualification in "in a neoclassical sense" because technocrats (or professional bureaucrats) in East Asian economies and in Singapore appear not to have adhered to neoclassical principles until the decade of the 1980s.

5Not even the accession of a new government in the Philippines with a vocal commitment to market-reform in 1986 (just about the time that these private capital flows were about to be launched) diverted much of these flows from Indonesia, Malaysia, and Thailand.

6This is a danger that Korean policy-makers, now that a self-reproducing private sector is in place, have become conscious about.