

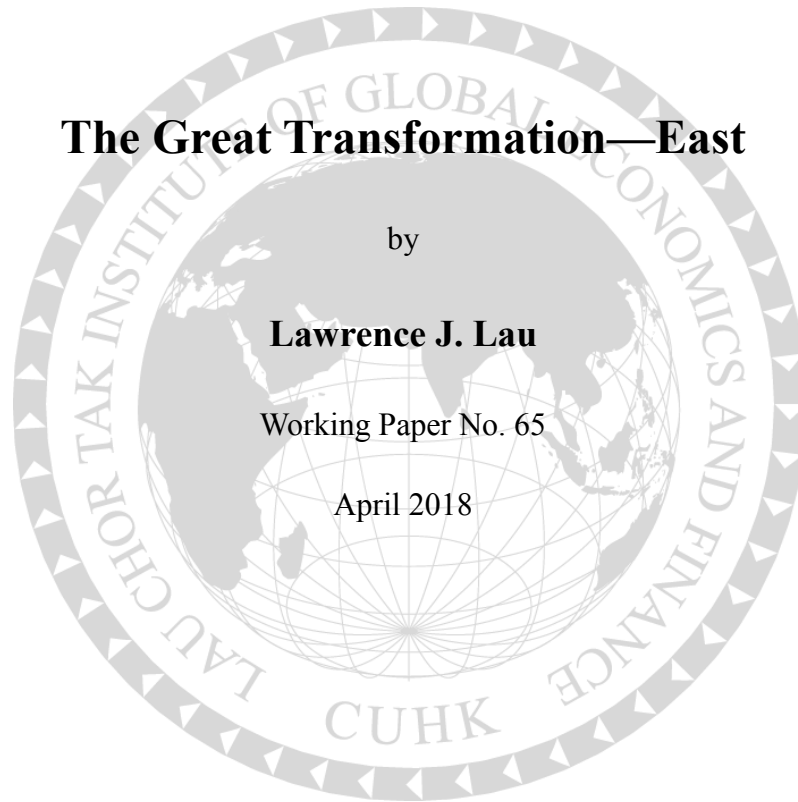
The Great Transformation—East

by

Lawrence J. Lau

Working Paper No. 65

April 2018



Lau Chor Tak Institute of Global Economics and Finance
The Chinese University of Hong Kong
13/F, Cheng Yu Tung Building, 12 Chak Cheung Street, Shatin, Hong Kong

Acknowledgements

The Lau Chor Tak Institute of Global Economics and Finance is grateful to the following individuals and organizations for their generous donations and sponsorship (in alphabetical order):

Donors

Johnson Cha	Agile Group Holdings Limited
Vincent H.C. Cheng	Asia Financial Holdings Ltd
Jonathan K.S. Choi	Bank of China (Hong Kong) Limited
Fred Hu Zulu	BCT Financial Limited
Tak Ho Kong	China Concept Consulting Ltd
Lau Chor Tak and Lau Chan So Har	First Eastern Investment Group
Lawrence J. Lau	Four Seas Group
Chien Lee	Hang Lung Properties Limited
Antony Leung	Henderson Land Development Co. Ltd.
Wei Bo Li	Hong Kong Exchanges and Clearing Limited
Francis Lui	Hony Capital Limited
Robert Ng	Industrial and Commercial Bank of China (Asia) Limited
Simon Suen	Lai Sun Development Co., Ltd.
Wong Ting Chung	Lau Chor Tak Foundation Limited
Lincoln Yung	Man Wah Holdings Limited
Allan Zeman	Sing Tao News Corporation Ltd.
	Sun Hung Kai Properties Ltd.
	Tai Sang Bank Limited
	The Bank of East Asia, Limited
	The Hongkong and Shanghai Banking Corporation Limited
	The Lanson Foundation
	Wing Lung Bank Limited

Programme Supporters

C.K. Chow	Bangkok Bank Public Co Ltd
Alvin Chua	Bank of China (Hong Kong) Limited
Fang Fang	Bank of China Limited - Phnom Penh Branch
Eddy Fong	Bei Shan Tang Foundation
Victor K. Fung	China Development Bank
Wei Bo Li	China Soft Capital
K.L. Wong	HOPU Investment Management Co Ltd
	Industrial and Commercial Bank of China - Phnom Penh Branch
	King Link Holding Limited
	Sun Wah Group
	The Santander-K Foundation
	UnionPay International

The Great Transformation—East[§]

Lawrence J. Lau¹

April 2018

Abstract: The objective of this paper is to identify the common factors that enable the East Asian economies to become developed in the post-World War II period. The East Asian economies have been able to take advantage of the open global economy. They all have sound economic fundamentals—a high domestic savings rate, the existence of abundant surplus labour, and investment in intangible capital—which provide the necessary domestic conditions for an economy to grow and prosper. They have also been able to maintain domestic macroeconomic stability and a relatively low rate of inflation, which are essential for the stability of the exchange rate and the success of an export promotion policy. They have all adopted export promotion, as opposed to import substitution, economic development policy, capitalising on their comparative advantages and using the exchange rate as one of the instruments. Exports also provided the initial growth in the aggregate demand for these economies. Finally, the continuity of governance has been an important factor in the early stage of development of these economies as it facilitates not only long-term planning but also faithful implementation of the plan once adopted.

[§] © 2018 Lau Chor Tak Institute of Global Economics and Finance, The Chinese University of Hong Kong

¹ The author is Ralph and Claire Landau Professor of Economics, The Chinese University of Hong Kong and Kwoh-Ting Li Professor in Economic Development, Emeritus, Stanford University. This is a revised version of a presentation made at the Lamfalussy Lectures Conference, Budapest, 12 February 2018. The author wishes to thank the Central Bank of Hungary for inviting him to the Conference and Mrs. Ayesha Macpherson Lau and Professor Yanyan Xiong for their helpful comments and suggestions. All opinions expressed herein are the author's own and do not necessarily reflect the views of any of the organisations with which the author is affiliated.

1. Introduction

Today, East Asia as a whole accounts for close to 30 percent of world GDP. Professor Angus Maddison (2006) estimated that China accounted for 30 percent of world GDP in the 18th Century. In 1970, China accounted for approximately 3 percent of world GDP. In 2017, China accounted for approximately 15 percent of world GDP. Japan accounted for 18 percent of world GDP at its peak in the mid-1990s. China and India are the two fastest-growing large economies in the world today.

In the post-Second World War period, quite a few East Asian economies, beginning with Japan, reached developed status. They include the “newly industrialised economies (NIEs)” of Hong Kong, South Korea, Singapore, and Taiwan, also referred to as the “four little dragons”. They were followed, in turn, by the other Association of Southeast Asian Nations (ASEAN) economies and by Mainland China,² which are still in the process of becoming developed. In the early 1950s, the Philippines was widely tipped to be the economy that was most likely to become developed. In fact, at the time, the Philippines had the highest GDP per capita in all of East Asia, higher than even that of Japan. Today, the Philippines still has the lowest GDP per capita among the five founding members of the ASEAN (the other four are Indonesia, Malaysia, Singapore, and Thailand).

The objective of this paper is to answer the question: How did the East grow rich? We begin by examining what successful East Asian economies have in common. All of these East Asian economies, beginning with Japan, adopted and implemented the economic development policy of export promotion. Export promotion turned out to be a successful policy for the then developing economies of East Asia because of the trade liberalisation around the world, beginning with the Kennedy Round (1964–1967) of trade negotiations under the General Agreement on Tariffs and Trade (GATT), the predecessor to the World Trade Organization (WTO).

Taiwan was among the first, if not the very first, developing economies to explicitly adopt and implement the economic development policy of export promotion instead of import substitution. It proved to be highly successful in enhancing domestic savings and investment,

² In this paper, China and “Mainland China” are used interchangeably.

attracting foreign direct investment, increasing employment, and stimulating economic development. Subsequently, these policies were also widely and successfully emulated by many other developing economies such as South Korea, the ASEAN, and Mainland China.

2. The Shifting Centre of Gravity of the Global Economy

In 1970, the United States and Western Europe together accounted for almost 60% of world GDP. By comparison, East Asia (defined as the 10 Association of Southeast Asian Nations (ASEAN)—Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam—+ 3 (China including Hong Kong, Macau and Taiwan, Japan, and the Republic of Korea)) accounted for only approximately 10% of world GDP. By 2016, the share of United States and Western Europe combined in world GDP has declined to approximately 41%, whereas the share of East Asia has risen to around 28%. The Japanese share of world GDP declined from a peak of almost 18% in the mid-1990s to 6.7% in 2016, while the Mainland Chinese share of world GDP rose from 3.1% in 1970 and less than 4% in 2000 to over 15.1% in 2016. See Charts 1 and 2.

Chart 1: The Distribution of World GDP, 1970

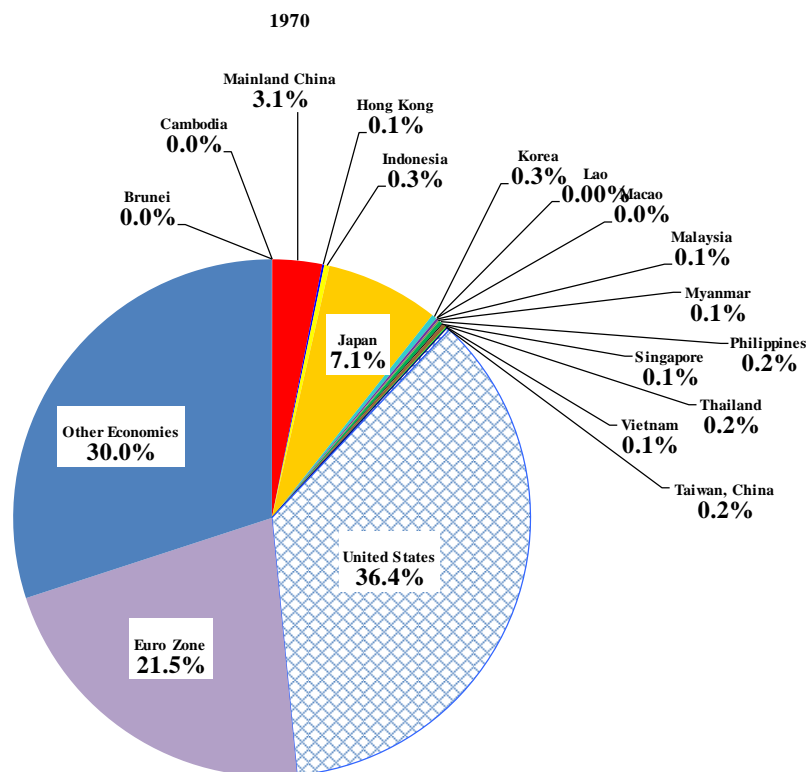
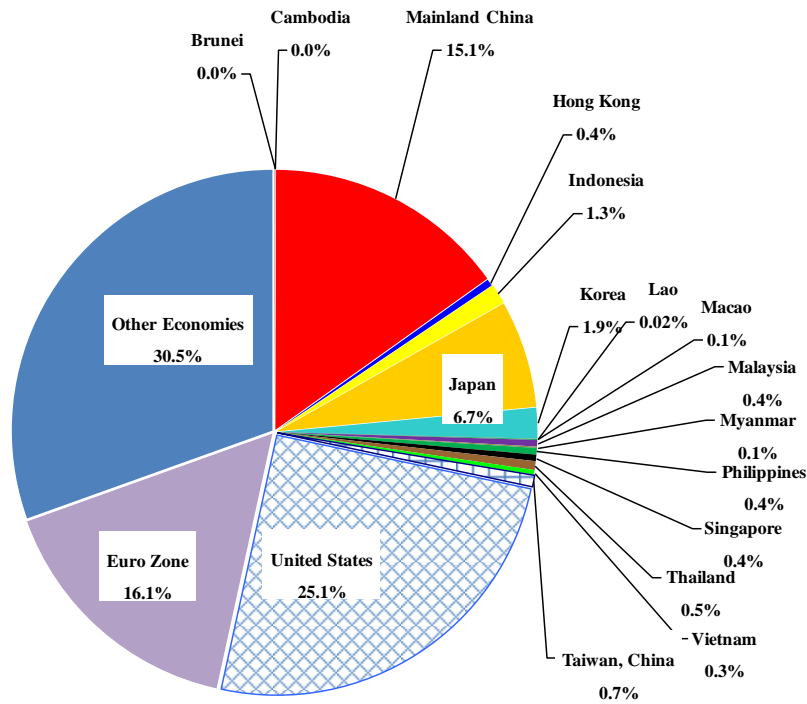


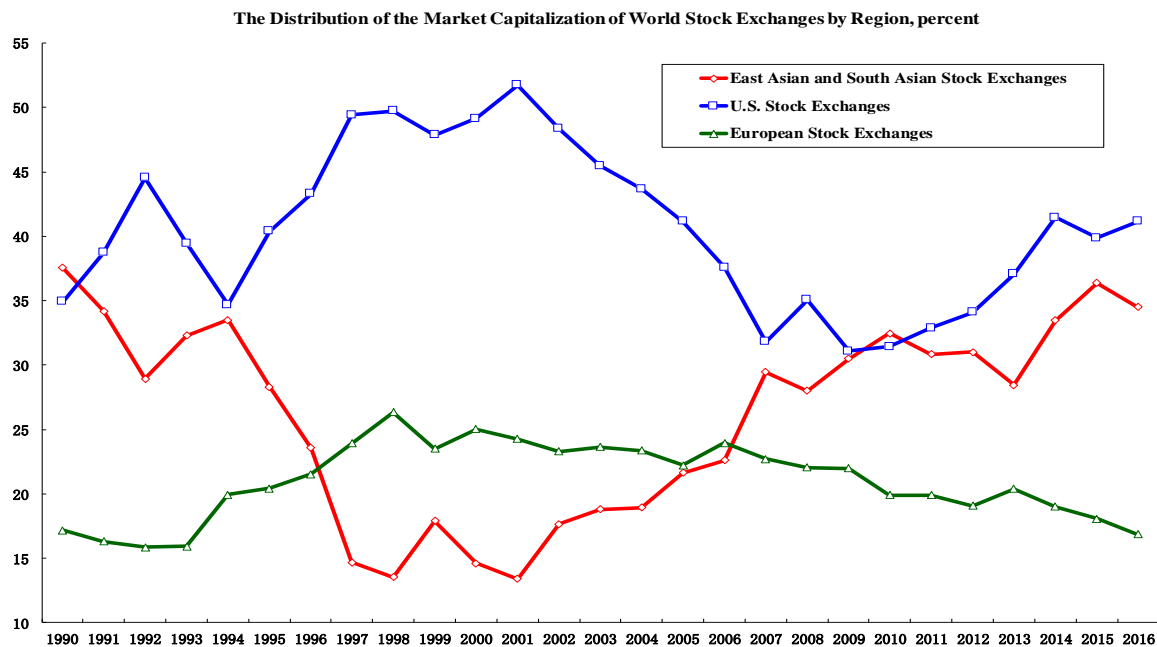
Chart 2: The Distribution of World GDP, 2016
2016



In 1970, the United States and Western Europe together accounted for 47% of world trade in goods and services. By comparison, East Asia accounted for 9.5% of world trade. By 2016, the share of United States and Western Europe combined in world trade has declined to 37.1%, whereas the share of East Asia has risen to 28.1%. The Mainland Chinese share of world trade rose from 0.6% in 1970 to 10.1% in 2016. The growth in Chinese international trade may be attributed in part to the adoption of current account convertibility of the Renminbi by China in 1994, accompanied by a significant devaluation of the Renminbi, and to Chinese accession to the World Trade Organization in 2001. Since 2015, Mainland China has also been the largest trading partner country of the U.S., surpassing Canada. See Charts 3 and 4.

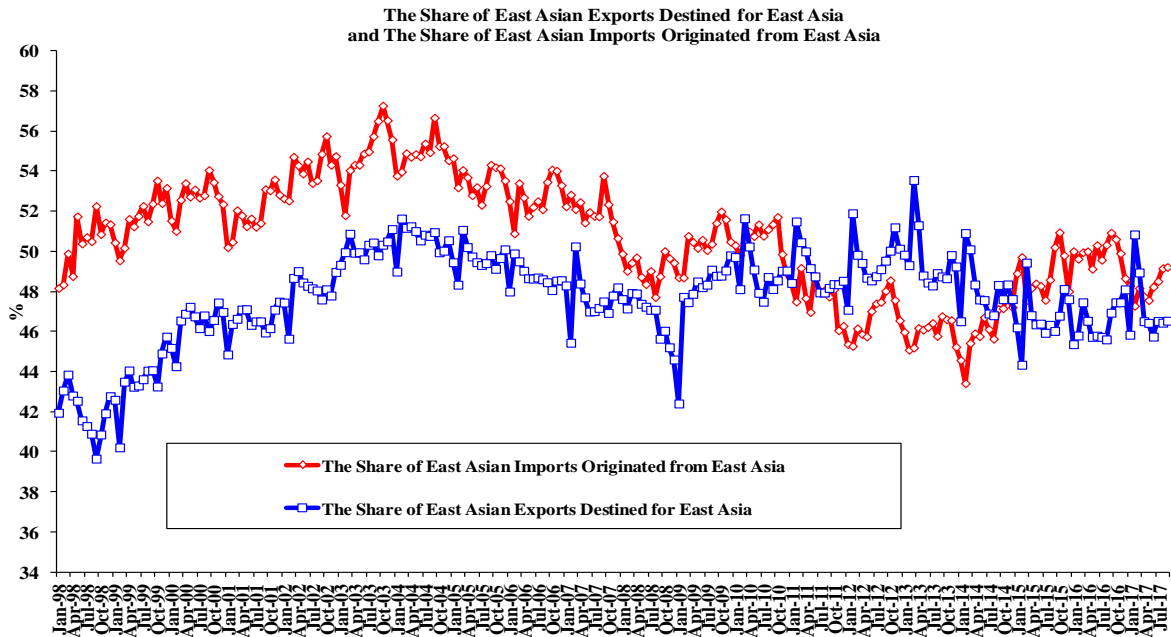
If we use the values of the market capitalisation of the stock exchanges of respectively the U.S., Europe, and East Asia and South Asia combined as a proxy for the values of their wealth (admittedly a crude one for many reasons), we can see that in 2001, the U.S. accounted for 50 percent of the world’s wealth, Europe not quite 25 percent and Asia as a whole just above 10 percent. In 2016, while the U.S. still accounted for approximately 40 percent, Asia rose to almost 35 percent and Europe fell to less than 20 percent. See Chart 5.

Chart 5: The Regional Distribution of the Market Capitalisation of Stock Exchanges, percent



Throughout the 2007–2009 global financial crisis, as well as the subsequent European sovereign debt crisis, the East Asian economies continued to do reasonably well. Mainland China, in particular, has been able to maintain its real rate of growth above 6.5% since 2007, lending credence to the “Partial De-Coupling Hypothesis”, that is, the East Asian economies can continue to grow, albeit at lower rates, even as the U.S. and European economies go into economic recession. This partial de-coupling can occur because of the shift of the economic centre of gravity of the world from the United States and Western Europe to Asia (including both East Asia and South Asia) over the past four decades. In terms of trade flows, thirty years ago, the trade flows were predominantly from East Asia to the United States and Western Europe. There was relatively little intra-East Asian trade. Today, intra-East Asian exports and imports account for approximately half of the total exports and imports of East Asia respectively (see Chart 6).

Chart 6: The Share of East Asian Exports Destined for East Asia and the Share of East Asian Imports Originated from East Asia



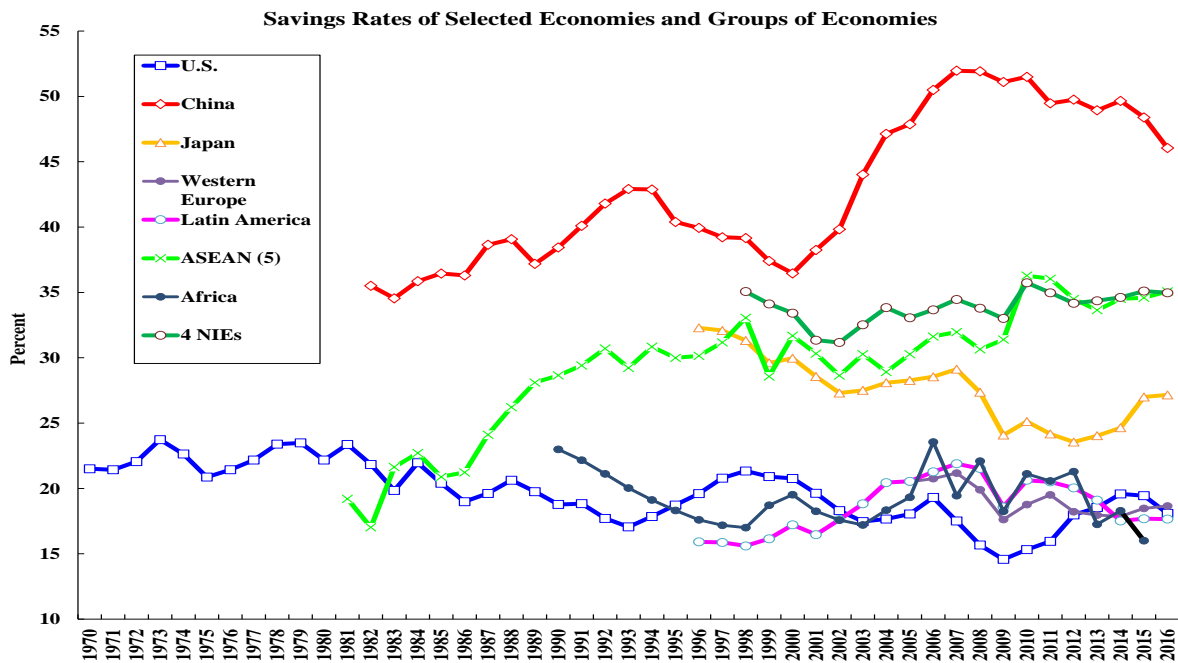
3. Economic Fundamentals

First, we consider the economic fundamentals of the East Asian economies. Most of them turn out to have a high domestic savings rate, abundant surplus labour, and significant cumulative investments in intangible capital such as human capital and research and development (R&D) capital.

A High Domestic Savings Rate

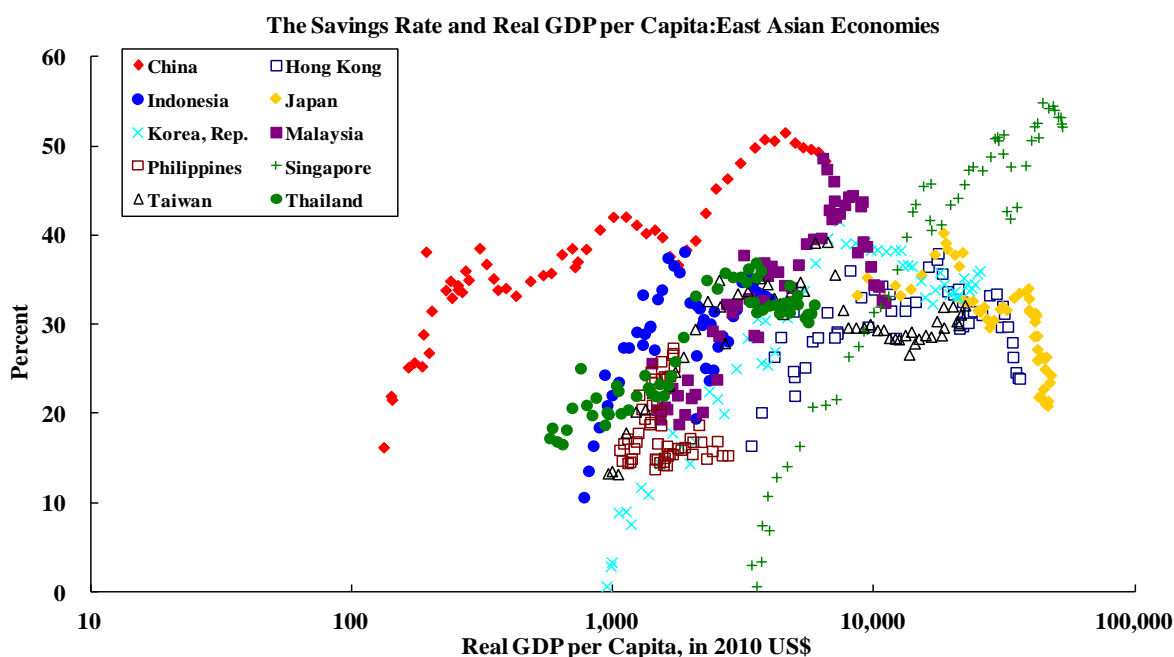
The domestic savings rates of East Asian economies have been consistently high, with the possible exception of the Philippines. Chart 7 shows that the savings rates of China, Japan, the East Asian NIEs, and the ASEAN five are all significantly higher than those of not only African and Latin American economies, where the savings rates are typically low, but also those of the U.S. and Western Europe (see Chart 7). A high domestic savings rate means that it is possible for the economy to maintain and sustain a high domestic investment rate without depending on the more fickle inflows of foreign aid, credits, loans, and direct and portfolio investment, enabling the tangible capital stock of the economy to grow consistently and continuously.

Chart 7: The Savings Rates of Selected Economies and Groups of Economies



In Chart 8, the savings rates of each economy are plotted against its real GDP per capita. The savings rate of an East Asian economy typically started out low when its real GDP per capita was low and near the subsistence level. However, the savings rate rose quickly as real GDP per capita exceeded the subsistence threshold. It is, however, sometimes necessary for an economy to have a jump-start with an initial supply of savings to support the initial investment—from, for example, a good agricultural harvest, land reform, foreign aid, credit, or investment. The recent measured savings rates of Japan, Korea, Taiwan, and the U.S. may appear low because of the traditional statistical practice of expensing educational and R&D expenditures, which properly speaking should have been recognised as investment expenditures rather than current expenditures and appropriately accumulated as stocks of intangible capital such as human capital and R&D capital.

**Chart 8: The Relationship between Savings Rate and Real GDP per Capita:
East Asian Economies**



Abundant Surplus Labour

East Asian economies are also endowed with abundant surplus labour. Their economic development has proceeded along the lines of Professor W. Arthur Lewis’s celebrated model of surplus labour, first introduced in his 1954 article, “Economic Development with Unlimited Supplies of Labour”. In almost every successfully developed East Asian economy, from Japan to Taiwan to South Korea to Mainland China and Southeast Asia, development began with the expanded employment of surplus labour from the agricultural sector in the non-agricultural sector, enabled by the continuing investment in tangible capital in the non-agricultural sector.³ Initially, the bulk of the additional output is exported.

During this surplus labour phase, tangible capital was accumulated in the non-agricultural sector, and surplus labour moved from the agricultural sector to the non-agricultural sector as complementary tangible capital became available in the non-agricultural sector. For such movement of labour to be sustainable, a relatively high domestic savings rate would be needed, both as a source of wage goods (food) and as a source of investable funds in the non-agricultural sector, unless they could be supplemented by imports and inflows of

³ The city economies of Hong Kong and Singapore were different because they did not start with a large primary sector. However, even then, they had significant unemployed or underemployed labour.

foreign capital. However, it is important to realise that the principal source of economic growth during this phase is not the surplus labour itself, but the accumulation of tangible capital in the non-agricultural sector, which made it possible for the surplus labour to move from the agricultural to the non-agricultural sector to be productively employed.

In the following series of charts (Chart 9–16), we show the changes in the distributions of GDP and employment by the three production sectors, primary (which includes agriculture and mining), secondary (which includes manufacturing), and tertiary (which includes services), over time in Japan, Taiwan, South Korea, and Mainland China. All of them started out with the primary sector accounting for the largest share of employment. With the growth of the economy and the secondary and tertiary sectors, the primary sector became progressively the sector accounting for first the smallest share of GDP and then the smallest share of employment.

Chart 9: The Distribution of Japanese GDP by Sector since 1970

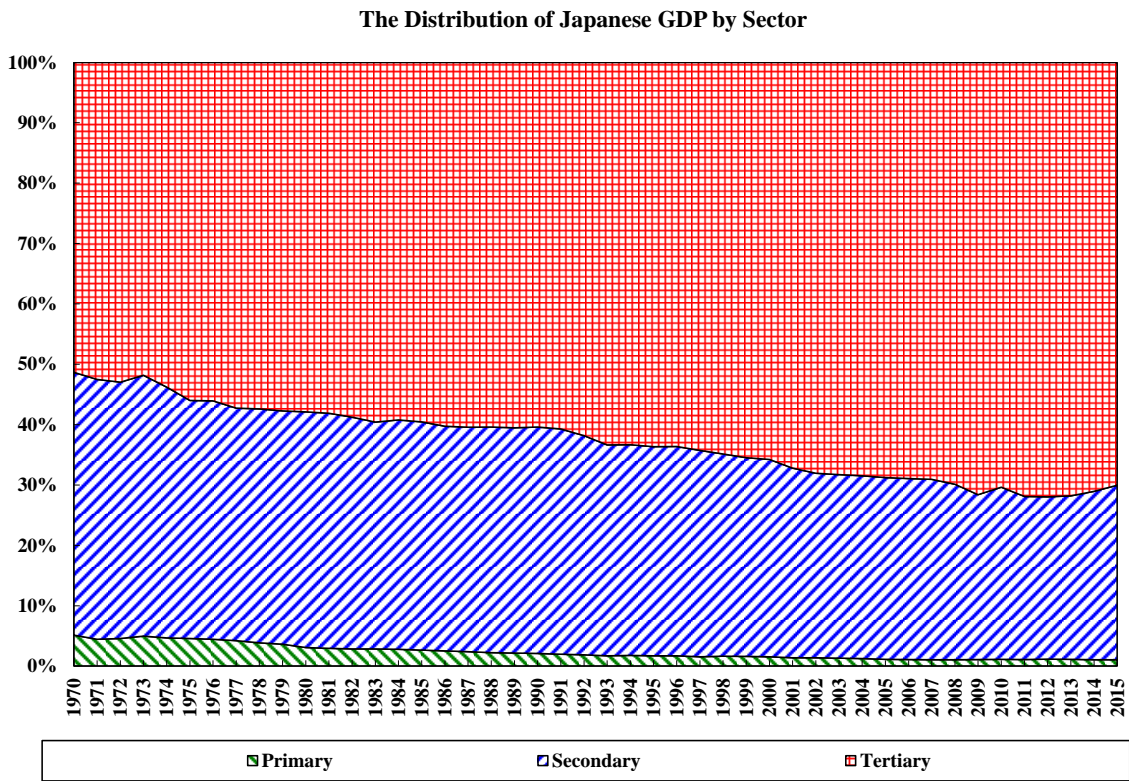


Chart 10: The Distribution of Japanese Employment by Sector since 1953

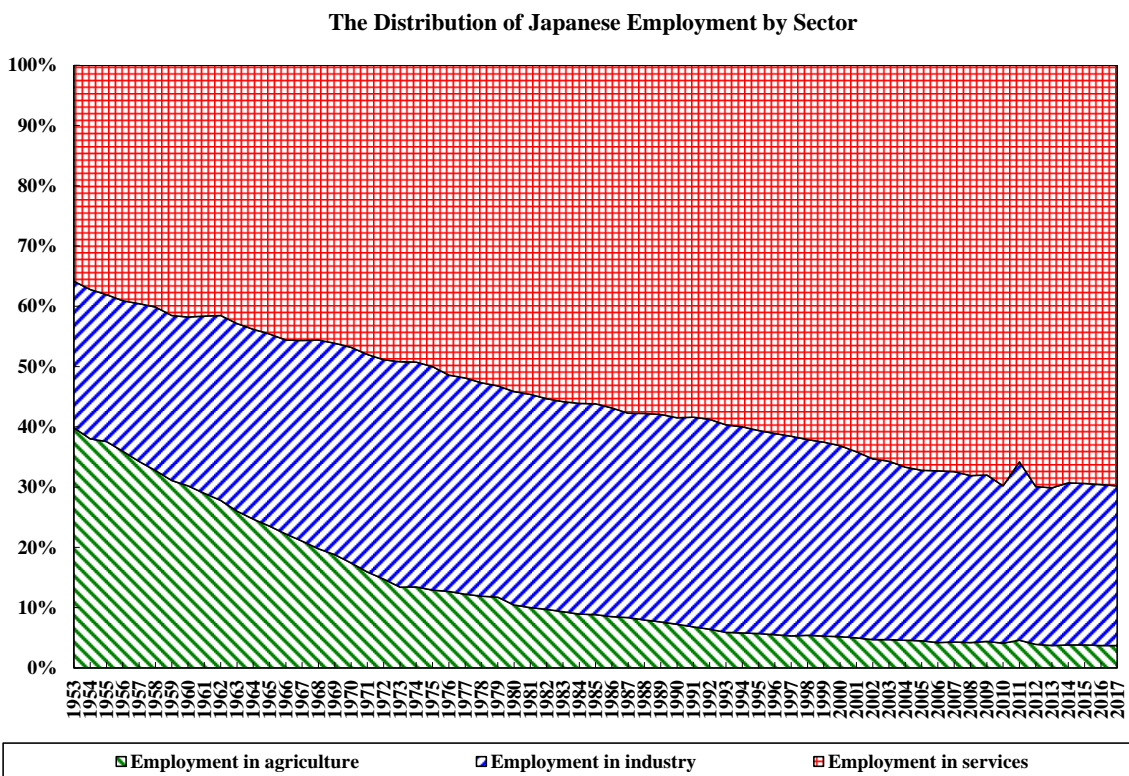


Chart 11: The Distribution of Taiwan GDP by Sector since 1951

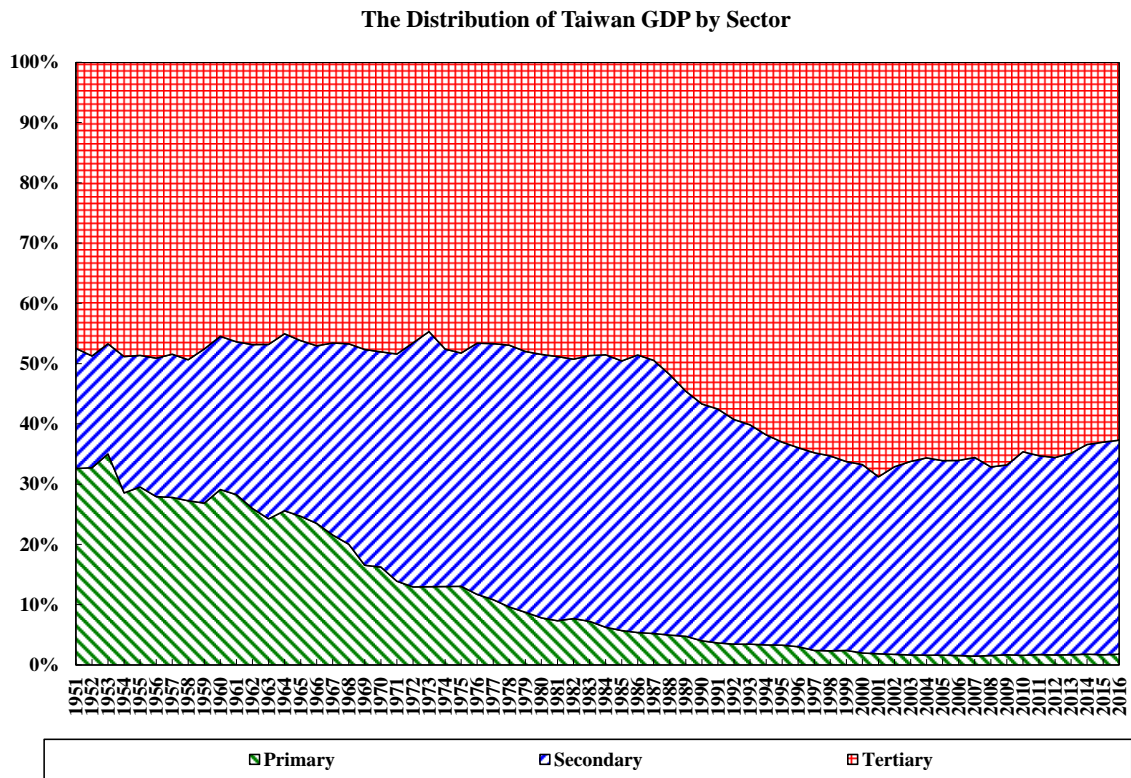


Chart 12: The Distribution of Taiwan Employment by Sector since 1951

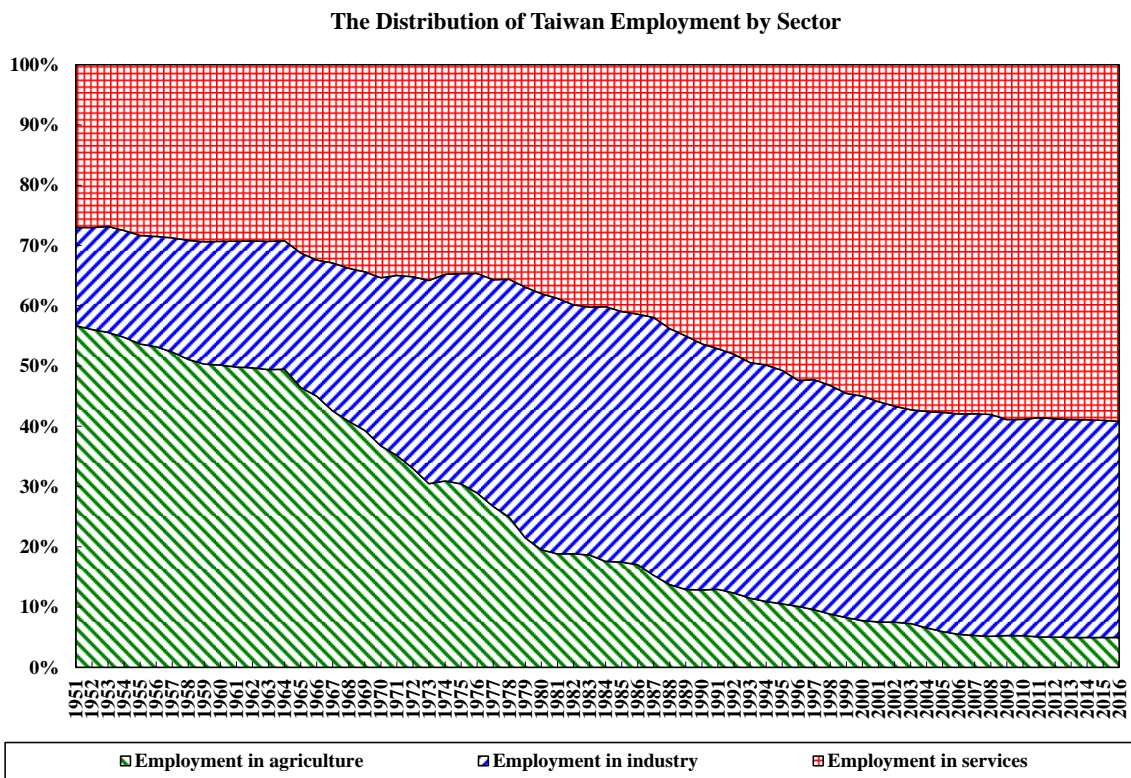


Chart 13: The Distribution of South Korean GDP by Sector since 1965

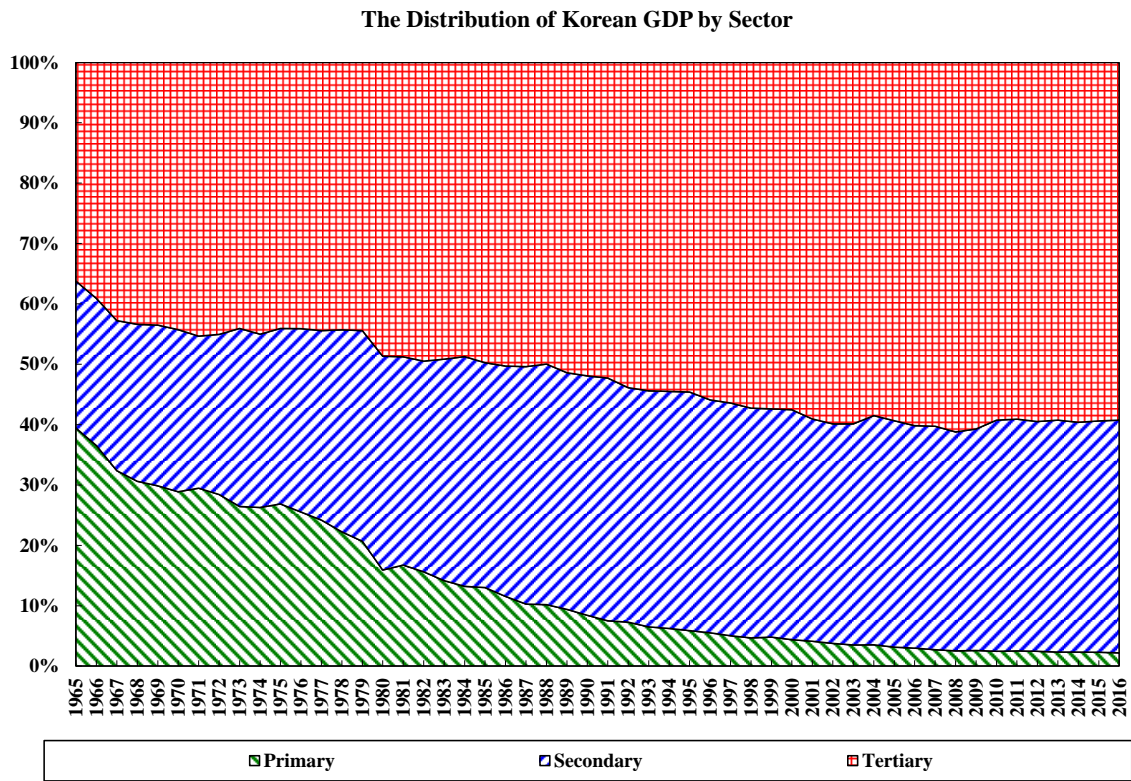


Chart 14: The Distribution of South Korean Employment by Sector since 1970

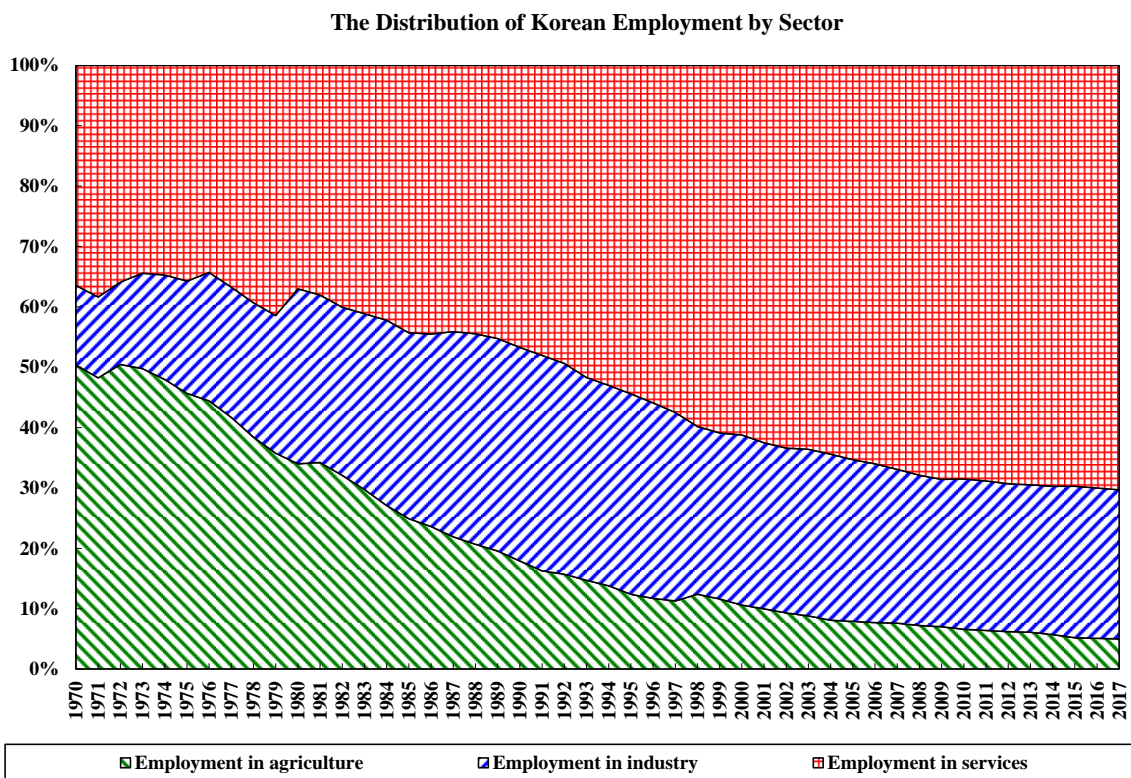


Chart 15: The Distribution of Chinese GDP by Sector since 1952

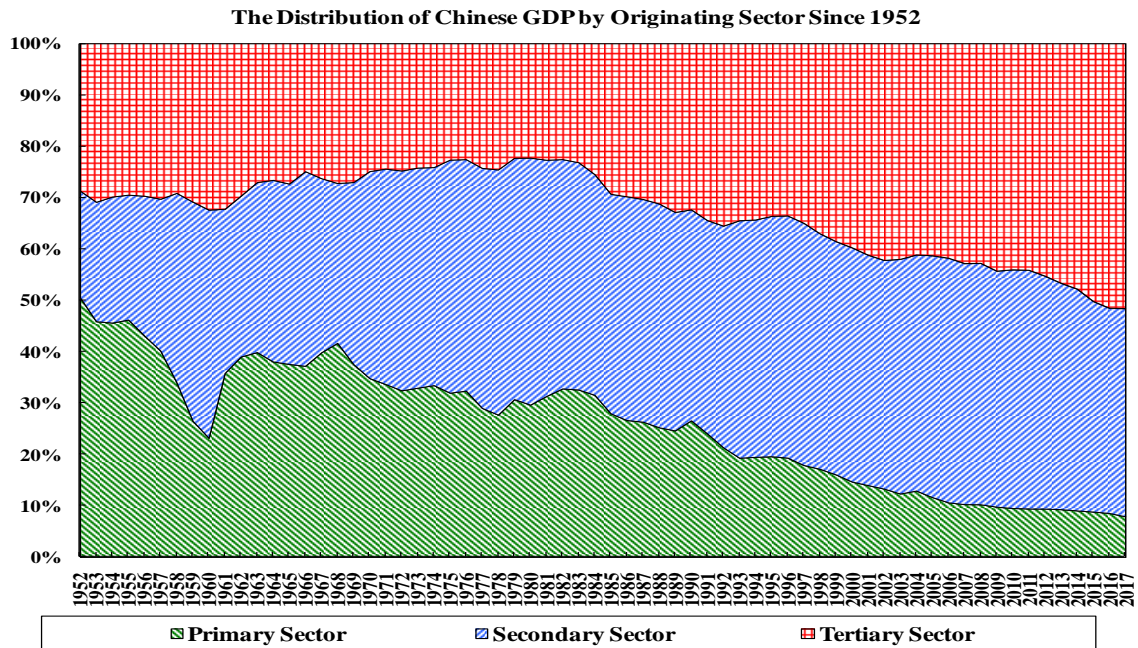
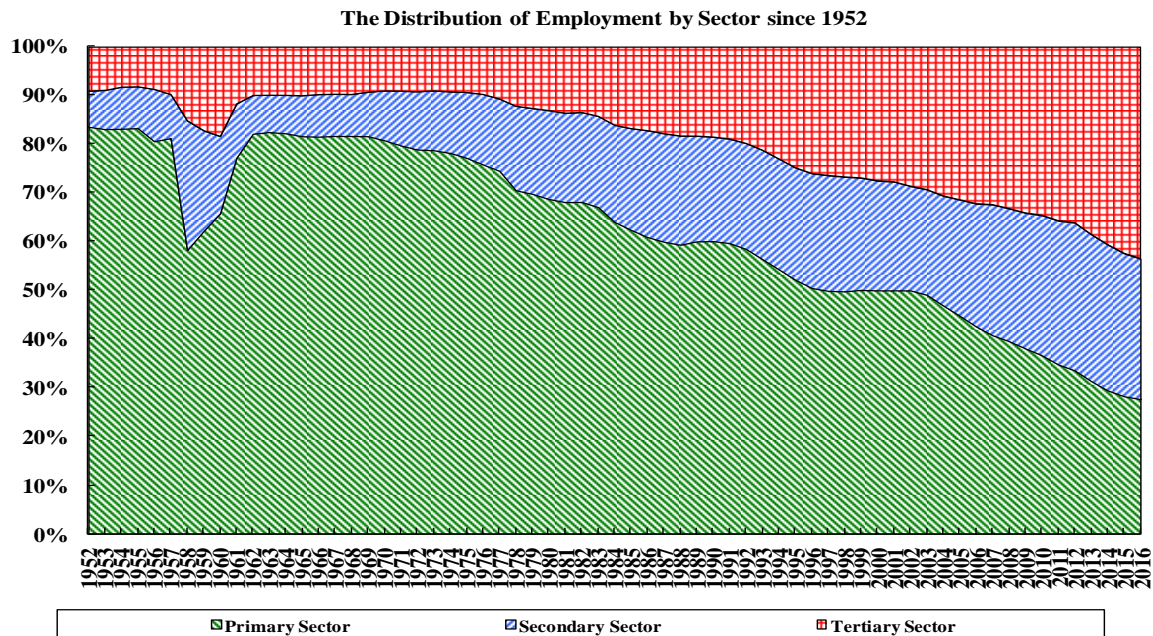


Chart 16: The Distribution of Chinese Employment by Sector since 1952

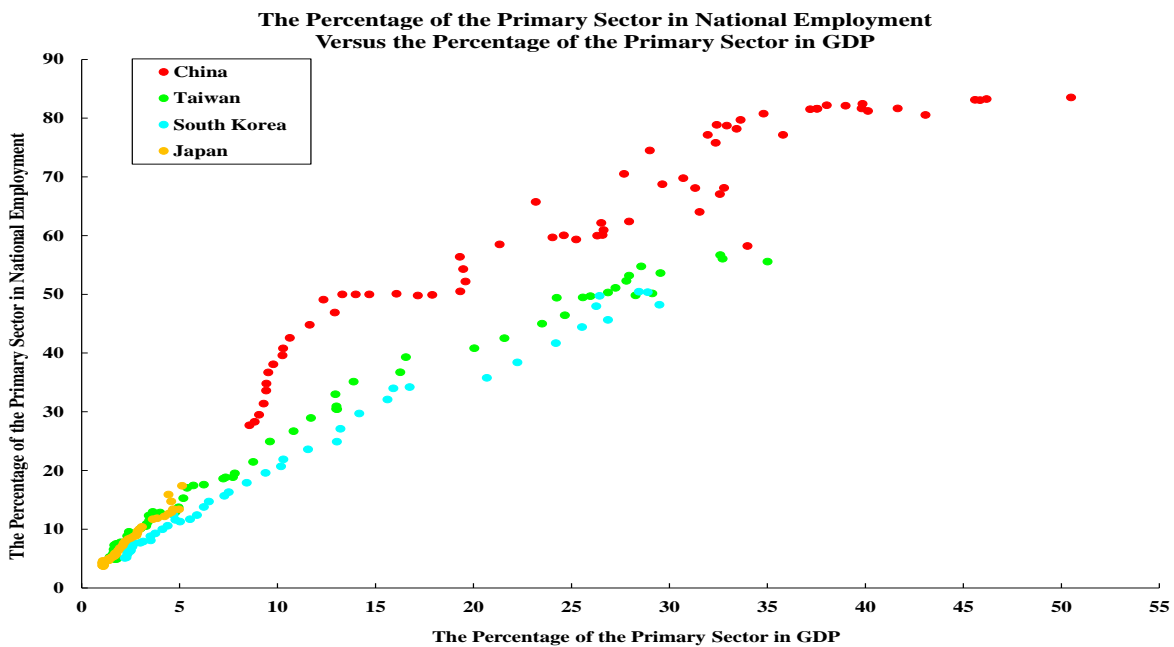


Several common features may be identified from these charts. First, as economic development proceeded, the share of GDP originating from the primary sector would decline continuously to below 10 percent. This has occurred in every single one of the economies of Japan, Taiwan, South Korea, and Mainland China. Second, the share of employment of the primary sector would also decline, but not to the same extent as the share of GDP. It has also

fallen below 10 percent except in Mainland China, the economically least developed of the four economies. Third, the tertiary sector in all four economies, including even Mainland China, has grown to be the largest sector in terms of the share of GDP. Fourth, the tertiary sector has also become the largest sector by employment.

In Chart 17, the share of the primary sector in total employment is plotted against its share in GDP for the four economies: Japan, Taiwan, South Korea, and Mainland China. It is clear that there was much more surplus labour in Mainland China historically than in the other three economies. What this means is that Mainland China will be able to continue to benefit from its surplus labour for a while longer. The primary sectors of Japan, Taiwan, and South Korea have already reached a point with a very low share of employment and an even lower share of GDP originating. The primary sector of Mainland China still has some distance to go before its share of employment drops below 10 percent.

Chart 17: The Share of the Primary Sector in Total Employment versus Its Share in GDP, Percent



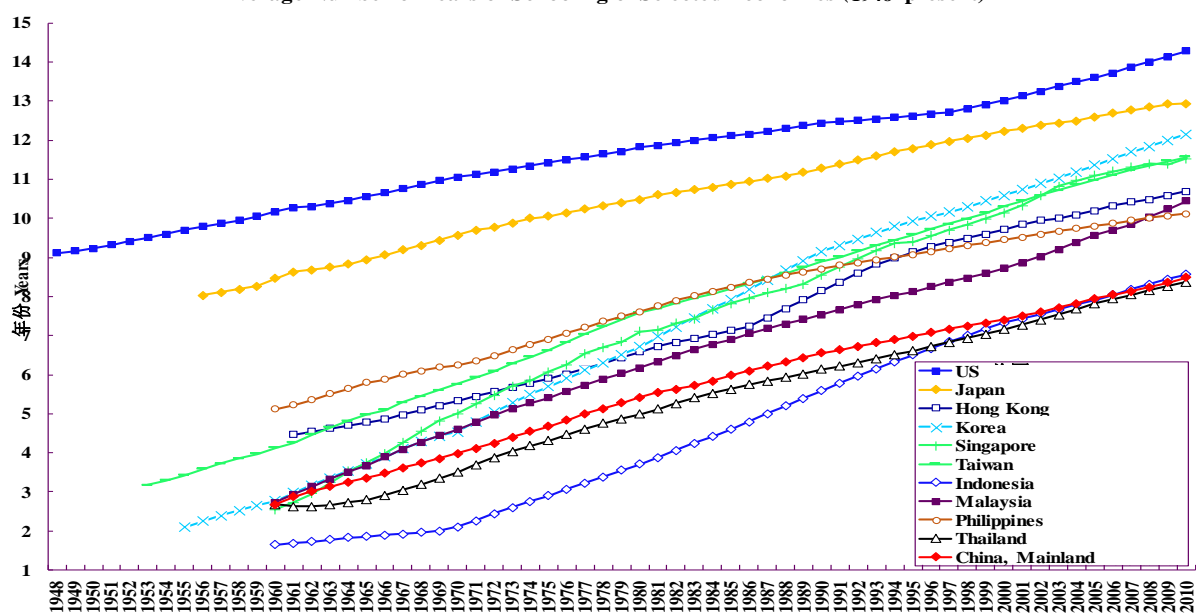
Investment in Intangible Capital

Innovation is the most important driving force of economic growth today, especially for mature developed economies with their already high capital-labour ratios and little, no, or even negative growth in the labour input measured in terms of labour hours. Sustained investment in intangible capital such as human capital and R&D is essential for the occurrence of economic innovation, reflected in measured technical progress or growth in total factor productivity in an economy. The East Asian economic development experience provides an example of created as opposed to natural comparative advantage. Japan, Hong Kong, South Korea, Singapore, Taiwan, and Mainland China all had little or no natural resources. However, they have all shown that human capital and R&D capital can substitute for natural resources.

East Asians have a long tradition of valuing education. One indicator of the level of human capital in an economy is the average number of years of schooling per person in the working-age population. In Chart 18, the average number of years of schooling is compared across selected economies. By this measure, the United States and Japan are clearly the global leaders. South Korea and Taiwan have also been catching up fast. Most of the other East Asian economies also have quite rapidly increasing levels of human capital but it will take a while before they can catch up with the levels of human capital in the developed economies.

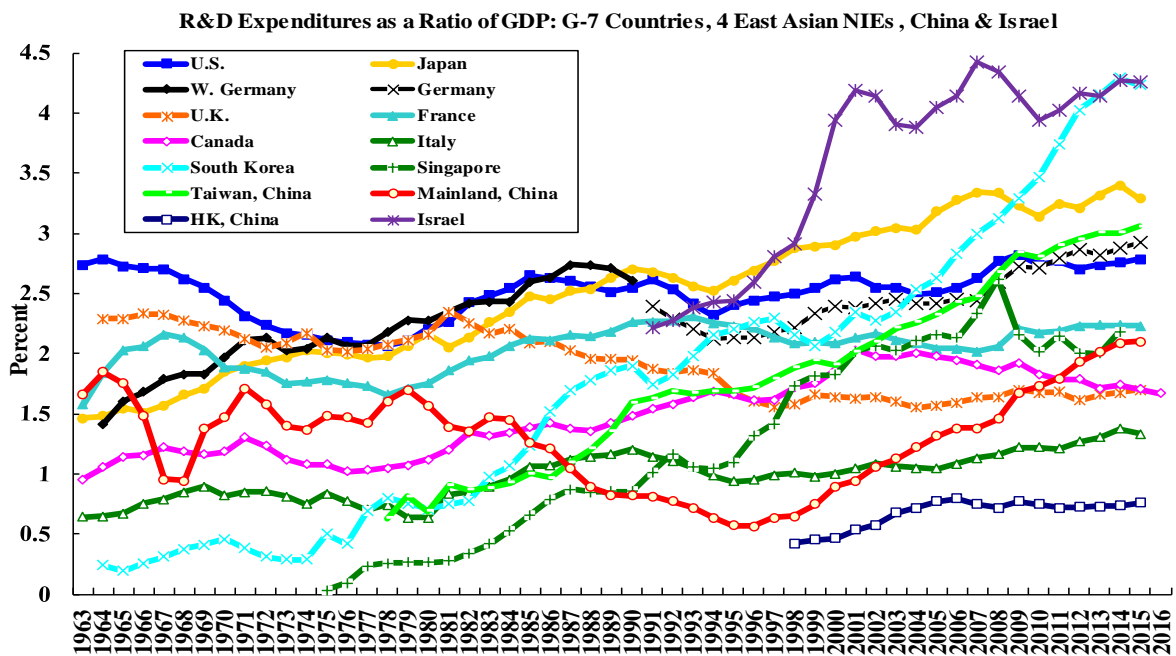
Chart 18: The Average Number of Years of Schooling per Person in the Working-Age Population, Selected Economies

Average Number of Years of Schooling of Selected Economies (1948 -present)



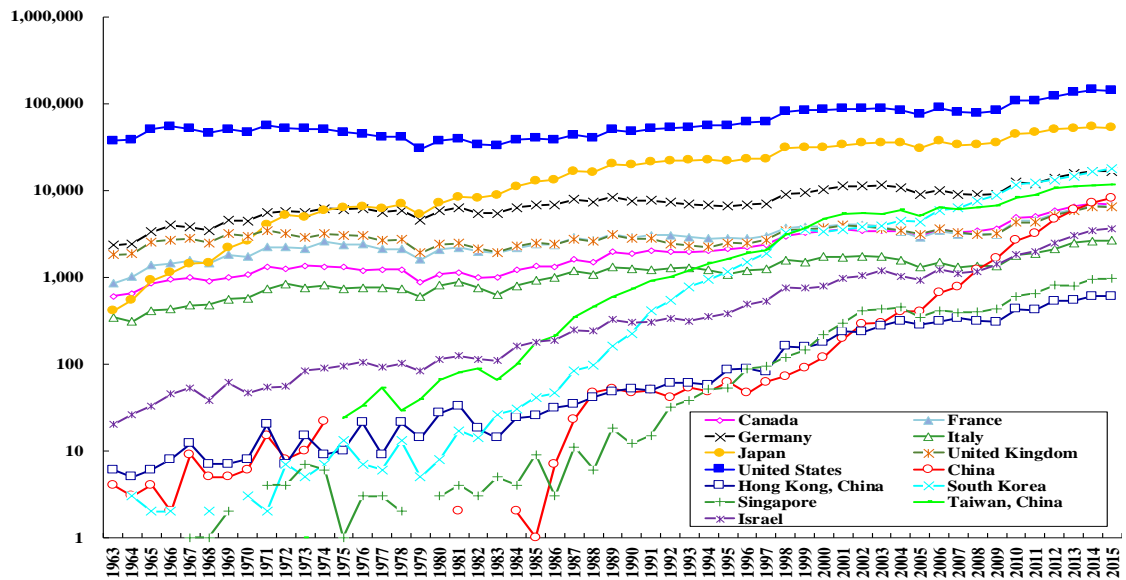
The annual expenditure on R&D as a percent of GDP are presented for selected economies in Chart 19. It shows that the U.S. has consistently invested a relatively high percent of its GDP in R&D. The East Asian economies, including Mainland China, has been catching up fast, with the exception of Hong Kong.

**Chart 19: R&D Expenditure as a Percent of GDP:
G-7 Countries, 4 East Asian NIES, China, and Israel**



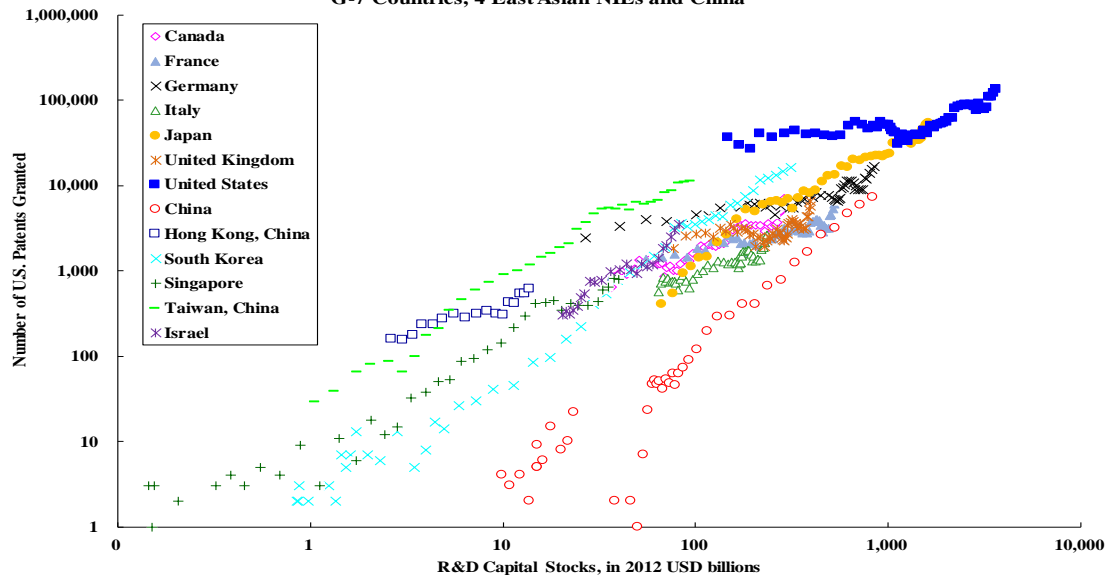
One indicator of the potential for technical progress (national innovative capacity) is the number of patents obtained each year. In Chart 20, the number of patents granted in the United States each year to the nationals of different countries, including the U.S. itself, over time is presented. The U.S. is the undisputed champion over the past forty years, with 140,969 patents granted in 2015, followed by Japan, with 52,409. (Since these are patents granted in the U.S., the U.S. may have a home advantage; however, for all the other countries and regions, the comparison across them should be fair.) The number of patents granted to Mainland Chinese applicants each year has increased from the single-digit levels prior to the mid-1980s to 8,166 in 2015. The economies of South Korea and Taiwan, granted 17,924 and 11,690 U.S. patents respectively in 2015, are still far ahead of Mainland China. In contrast, the number of U.S. patents granted to Hong Kong nationals was only 601 in 2015.

**Chart 20: Patents Granted in the United States:
G-7 Countries, 4 East Asian NIEs, China, and Israel**
Patents Granted in the United States: G-7 Countries, 4 East Asian NIEs, China & Israel



The R&D capital stock, defined as the cumulative past real expenditure on R&D less depreciation of 10% per year, is a useful indicator of innovative capacity. R&D expenditures should quite properly be treated as investment since R&D efforts generally take years to yield any result. R&D capital can be shown to have a direct causal relationship to the number of patents granted. Chart 21, in which the annual number of U.S. patents granted is plotted against the R&D capital stock of that year for each economy, shows clearly that the higher the stock of R&D capital of an economy, the higher is the number of patents granted to it by the U.S.

**Chart 21: The Relationship between U.S. Patents Granted and R&D Capital Stocks:
G-7 Countries, 4 EANIEs, China, and Israel**
U.S. Patents Granted and R&D Capital Stocks:
G-7 Countries, 4 East Asian NIEs and China



4. Economic Development Policies

Even sound economic fundamentals do not guarantee successful economic development. Correct economic development policies must be adopted. For East Asian economies, three common economic development policies can be identified: the maintenance of macroeconomic stability, the opening of the economy, and export promotion on the basis of comparative advantages.

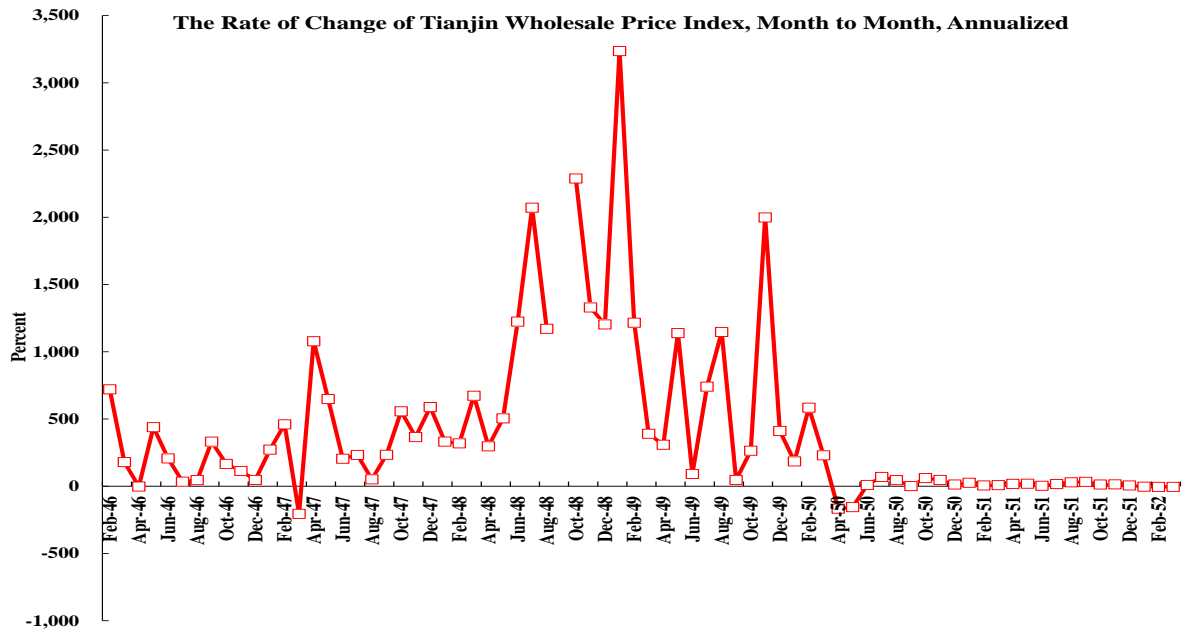
Maintenance of Macroeconomic Stability

Domestic macroeconomic stability is crucial for households, enterprises, and governments to think and plan long-term. Without long-term planning, there will be no investment, public or private, and in particular, there will be no investment in the needed basic infrastructure. Moreover, opening of the domestic economy in the absence of a minimum degree of macroeconomic stability is risky because it will lead to massive capital flight, significant devaluation, and even more inflation. The control of inflation is thus an integral part of maintaining macroeconomic stability. It is also essential for the stabilisation of the exchange rate, which in turn makes it possible for the economic development policy of export promotion to be successfully implemented. Furthermore, a high rate of inflation often makes the income distribution more unequal. Inflation favors net borrowers and penalises net savers. Low-income individuals and retired individuals are also the least able to cope with the effects of inflation.

In 1947, there was hyperinflation in Mainland China. The late Professor Sho-Chieh Tsiang proposed the issuance of inflation-indexed retail bonds, with both the principal and interest tied to the rate of inflation, as a way to tame it. The key is that if the commitment of the government to fight inflation is perceived by the public to be credible, inflationary expectations can be changed. Regrettably, this proposal was not adopted by the Nationalist government at the time. But when the Chinese Communists came to power in 1949, they adopted and implemented the indexing proposal, launching a kind of bank deposit the principal and interest of which were indexed to the rates of change in the prices of a (weighted) basket of five goods—including rice, oil, salt, and cotton cloth. These indexed bank deposits helped bring down the rate of inflation on the Mainland very quickly.

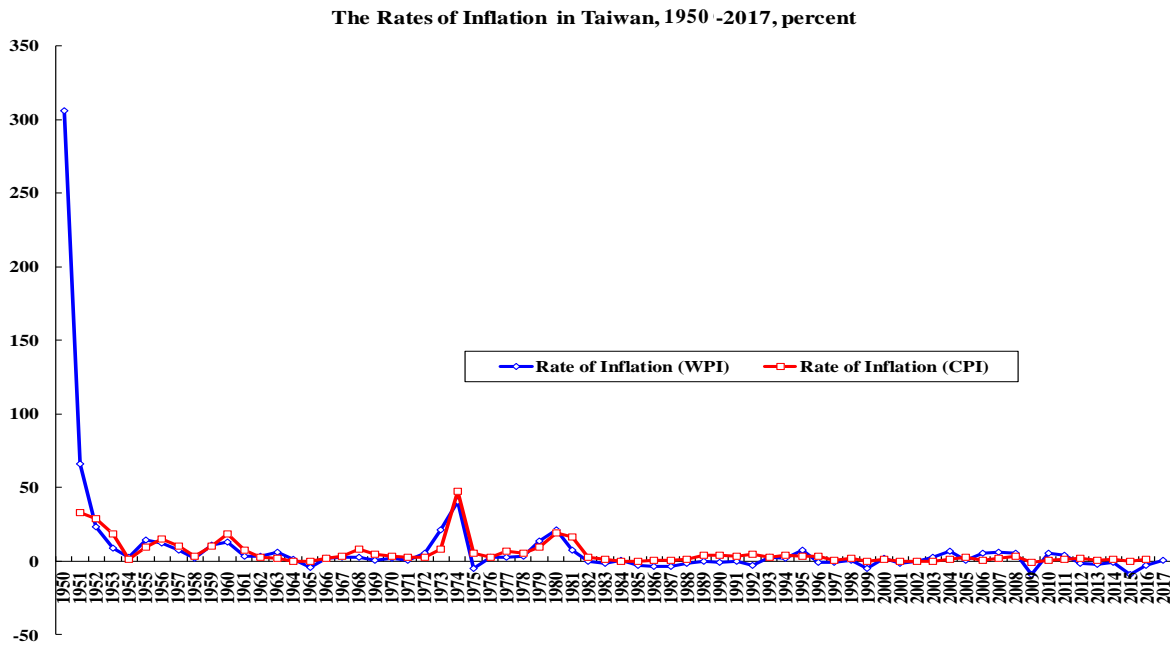
In January 1949, the rate of inflation on the Mainland was running at an annual rate of more than 3,000 percent! By June 1950, the rate of inflation fell to only 10 percent. By 1952, the price index began falling in absolute terms, at which point the Chinese Government modified the rate of interest formula so that while it would go up with the rate of inflation, it would not go down when inflation turned negative. In Chart 22, the wholesale price index of the City of Tianjin between 1946 and 1952, compiled by Nankai University, is presented. No nationwide price indices were available for China during this period, but the price index of Tianjin is believed to be broadly representative of the rates of inflation in other urban areas in Mainland China at the time. Chart 22 shows how the introduction of indexed deposits brought down the rate of inflation very quickly on the Mainland.

**Chart 22: The Monthly Rate of Inflation on the Mainland, 1946–52
(Tianjin Wholesale Price Index)**



Inflation was also very high in Taiwan in 1949–1950, it was also brought down relatively quickly by the government by maintaining a nominal rate of interest higher than the actual rate of inflation so that the real rate of interest would almost always be positive.

**Chart 23: The Rates of Inflation of Taiwan, 1950–2017,
as Measured by the Wholesale and Consumer Price Indices**



Opening of the Economy

Japan, the East Asian “newly industrialised economies (NIEs)”, and Mainland China all had little natural resources. Capital equipment, oil, and raw materials such as cotton all had to be imported. Thus, an open economy is essential for their industrialisation. To finance these imports in a sustainable manner, there must be exports, and exports to the world must follow the principles of comparative advantage. In the case of these economies, they would begin with specialisation in the production of labour-intensive light-manufactured goods. Opening the economy also attracted foreign direct investment (FDI) to augment domestic savings and facilitated technology transfer.

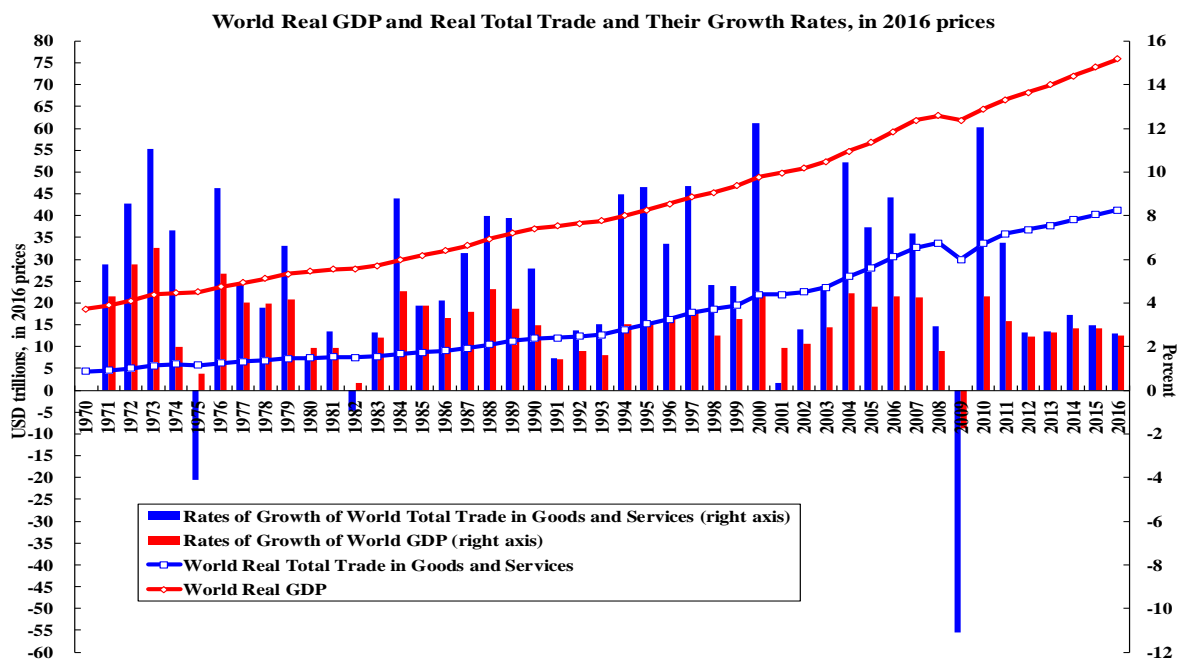
The Promotion of Exports

First Japan, and then Hong Kong, and then Taiwan successively and successfully adopted and implemented the economic development policy of export promotion. This was accompanied by a significant devaluation of the respective currencies and the introduction of various direct and indirect incentives for exporters. However, import substitution, rather than export promotion, was the policy of choice of Western development economists in the 1950s.

For example, India was advised to engage in import substitution as a strategy for its economic development. It proved to be a failed strategy.

In Chart 24, the levels and the rates of growth of real world GDP and real world trade are presented. The red and blue lines in Chart 24 represent the levels of real world GDP and real world trade in 2016 prices respectively. The red and blue columns represent the rates of growth of real world GDP and real world trade respectively. It is clear that the blue columns are much higher than the red columns until the global financial crisis of 2008, showing that the growth of world trade led the growth of world GDP until recently.

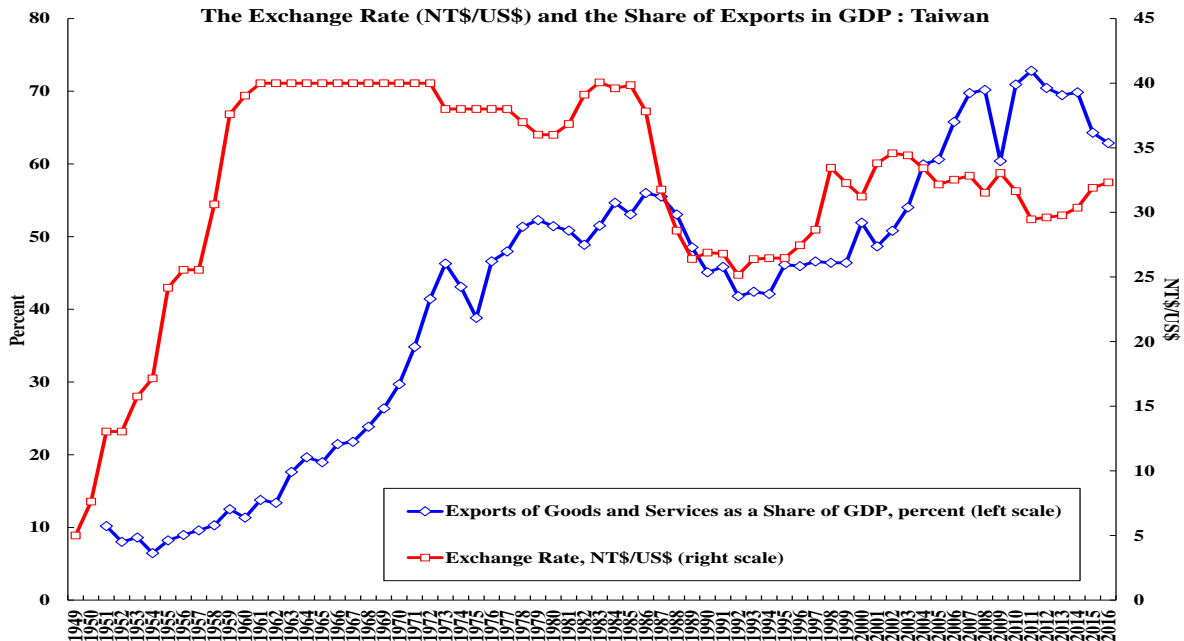
Chart 24: Real World GDP and Trade in Goods and Services and Their Growth Rates (2016 prices)



Among the instruments used for the promotion of exports is the exchange rate. It should be set at a level that makes an economy’s exports competitive in the world market, consistent with its comparative advantages. In Chart 25, the weighted average exchange rate of Taiwan and its share of exports in GDP are presented. After a series of significant devaluations, the multiple exchange rates were finally unified around 1959 at approximately NT\$40 per US\$. These devaluations enabled exports to increase rapidly in both absolute terms and as a percent of GDP. By the late 1980s, exports constituted over 50 percent of GDP. Subsequently, the NT\$ appreciated as trade surpluses piled up. A further devaluation in 1996–1997, in response

to the East Asian currency crisis, caused exports to rise further to approximately 70 percent of GDP. Currently, exports are approximately 65 percent of GDP in Taiwan.

Chart 25: The Nominal Exchange Rate and Exports as a Share of GDP: Taiwan



The patterns in South Korea, Mainland China, and Vietnam are basically similar—a devaluation of the domestic currency leads to an increase in the share of exports in GDP (see Charts 26–28).

Chart 26: The Nominal Exchange Rate and Exports as a Share of GDP: South Korea

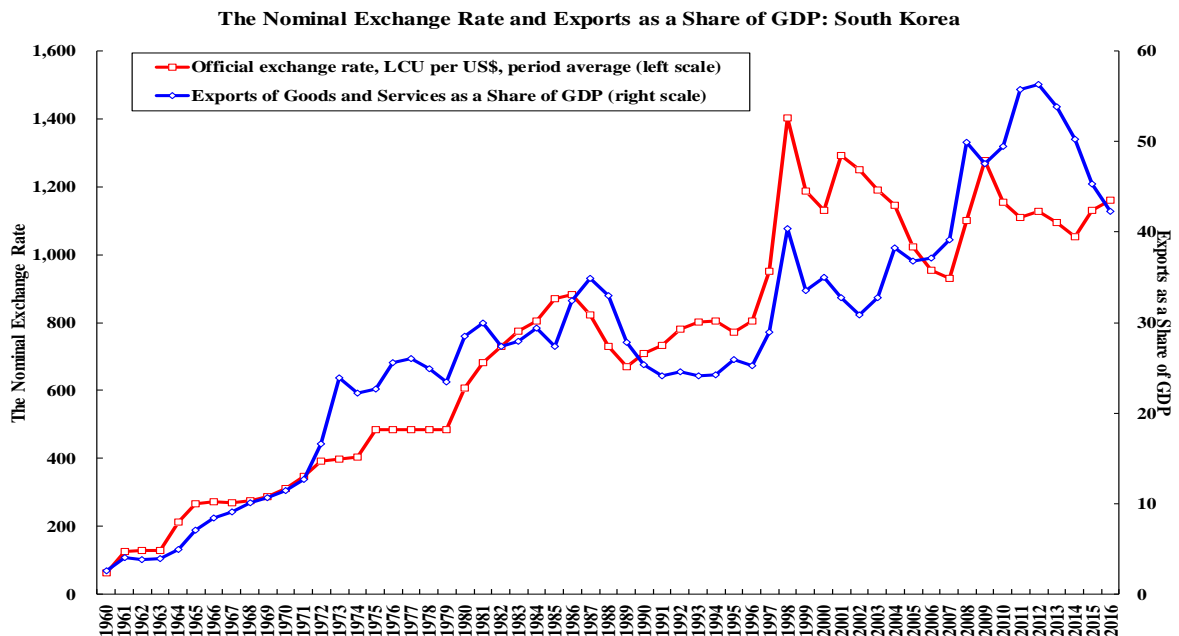


Chart 27: The Nominal Exchange Rate and Exports as a Share of GDP: Mainland China

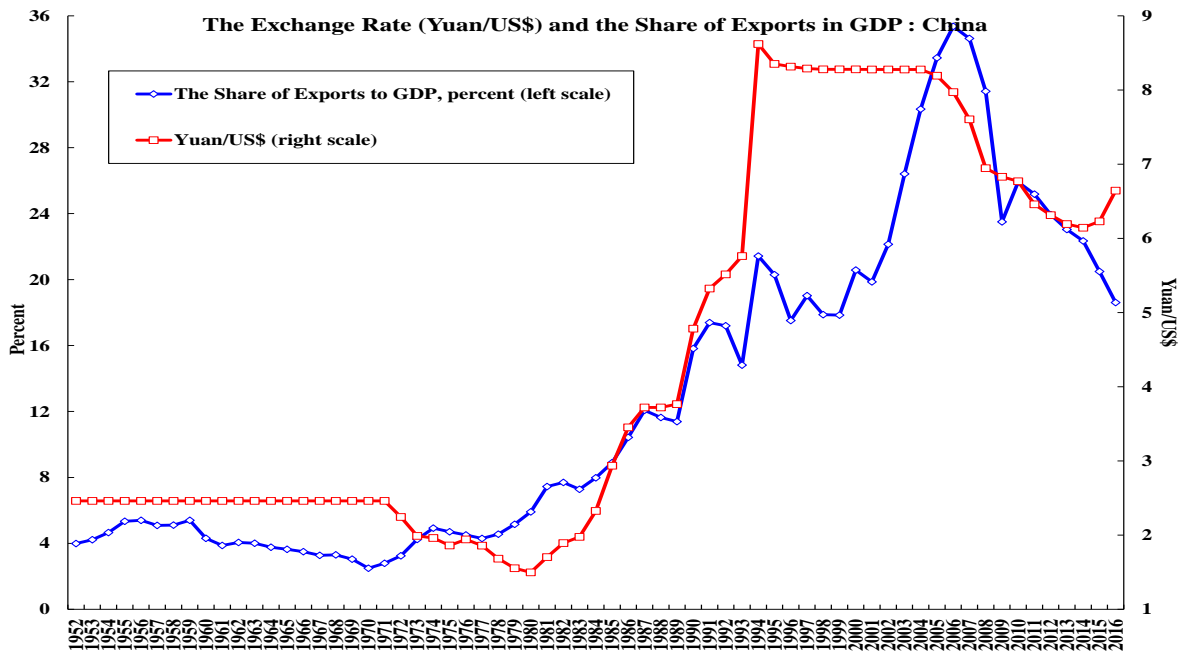
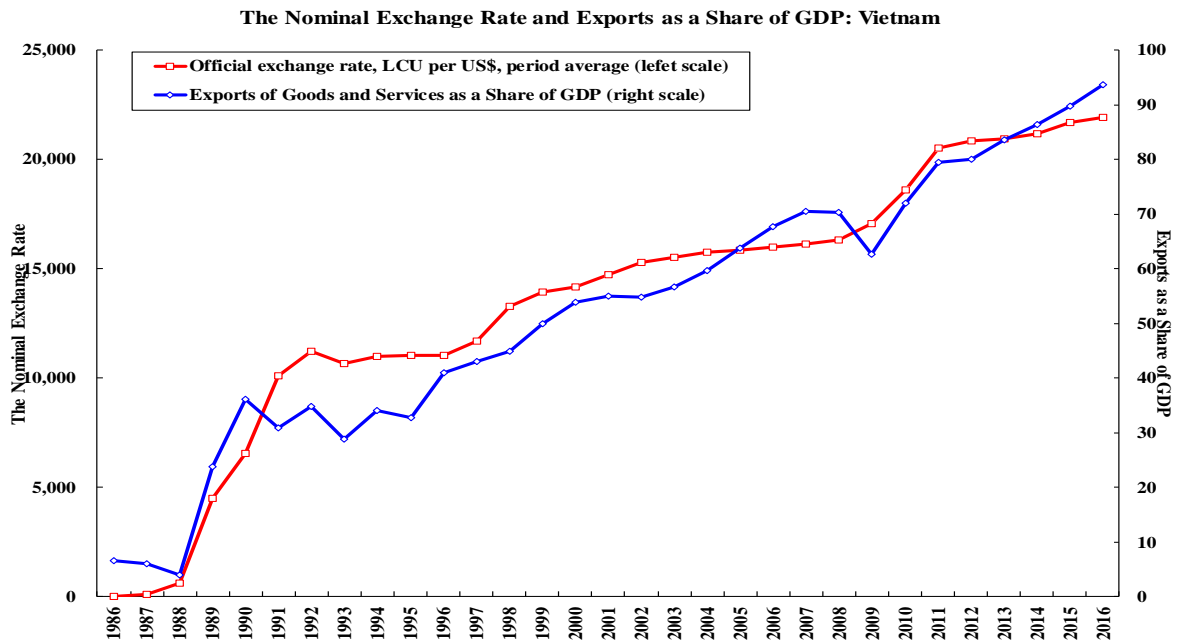


Chart 28: The Nominal Exchange Rate and Exports as a Share of GDP: Vietnam



5. The Sources of Economic Growth

Our research, starting with Kim and Lau (1994, 1995, 1996), indicates that the bulk of economic growth at the beginning stage of economic development can be attributed to the accumulation of tangible capital. There is little evidence of technical progress or growth of total factor productivity at the early development stage.⁴ It is only after these economies had made significant investments in intangible capital such as human capital and R&D capital over a period of time that they began to have measured technical progress or growth in total factor productivity.

The exception would be an economy such as Mainland China, which used to operate under a centrally planned economic system, with significant inefficiency. With the launch of the economic reform in 1978, introducing producer autonomy and free markets, there was a significant increase in output through the improvement in efficiency, even in the absence of an increase in measured inputs. This increased efficiency in turn would be manifested in measured technical progress or growth in total factor productivity. Lau and Zheng (2017) attempted to estimate the degree of inefficiency on the eve of Chinese economic reform in 1978. They conclude that Chinese output could have been approximately 50 percent higher if the Chinese economy were operating on its production possibilities frontier at the time.

6. Continuity of Governance

One common feature of the early development stages of the East Asian economies is that they were all characterised by continuous one-party rule, beginning with the Liberal Democratic Party in Japan, the British Colonial Government in Hong Kong, the Kuomintang (Nationalist Party) in Taiwan, President Park Chung-Hee in South Korea, Prime Minister Lee Kuan Yew of Singapore, and then Mainland China and Vietnam, just to name a few.

The advantages of continuous one-party rule are as follows: first, it is possible to plan long-term, without regard to the election cycle, as there is no need to settle for only short-term outcomes (basic infrastructure, so critical in the early development stage, can only be provided by a government with a long-term perspective); second, there is consistency, continuity, and

⁴ See also Krugman (1994).

predictability in economic policy; and third, the households and enterprises can share a common long-term vision and common expectations about the future, facilitating investment planning and coordination. Of course, this is not to say that there are no disadvantages to continuous one-party rule. Many countries governed by dictatorships are among the poorest in the world. But when one-party rule works well, it is better and more efficient than any other system.

7. Concluding Remarks

The development experiences of East Asian economies show that an open global economy can provide the environment for developing economies to grow and prosper through international trade. The East Asian economies have all benefitted significantly from the economic globalisation since the Second World War. The East Asian experiences also show that domestic macroeconomic stability is important. Without macroeconomic stability, no one will think or plan long-term, and investment will dry up. Moreover, opening of the domestic economy in the absence of a minimum degree of macroeconomic stability is risky because it will lead to massive capital flight, significant devaluation, and even more inflation. A low rate of inflation is also essential to the maintenance of a relatively stable exchange rate and the success of an export promotion policy.

The development experiences of East Asian economies also confirm the importance of sound economic fundamentals: a high domestic savings rate, the existence of abundant surplus labour, and investment in intangible capital provide the necessary domestic conditions for an economy to grow and prosper. However, a source of aggregate demand is also needed in order to be able to make full use of domestic resources, especially the surplus labour. Exports can provide the initial growth in aggregate demand. Today, no one argues seriously for import substitution as the sole policy to promote economic development. One important reason is the lack of sufficient domestic demand when the GDP per capita is still at a low level. Another important reason is that what needs to be imported can only be produced domestically at a very high cost, even if it is possible to do so at all. Most economies are better off exporting other things that they can more easily make themselves, capitalising on their comparative advantages.

Finally, the continuity of governance has been an important factor in the early stage of development of the East Asian economies, as it facilitates not only long-term planning but also

faithful implementation of the plan once adopted. This affects in particular the investment in needed basic infrastructure, such as highways, ports, and power plants, which is especially critical at the early stage of economic development.

References

- Jong-Il Kim and Lawrence J. Lau (1994), "The Sources of Economic Growth of the East Asian Newly Industrialized Countries," Journal of the Japanese and International Economies, Vol. 8, No. 3, September, pp. 235-271.
- Jong-Il Kim and Lawrence J. Lau (1995), "The Role of Human Capital in the Economic Growth of the East Asian Newly Industrialised Countries," Asia-Pacific Economic Review, Vol. 1, No. 3, December, pp. 3-22.
- Jong-Il Kim and Lawrence J. Lau (1996), "The Sources of Asian Pacific Economic Growth," Canadian Journal of Economics, Vol. 29, Special Issue, April, pp. S448-S454
- Paul Krugman (1994), "The Myth of Asia's Miracle," Foreign Affairs, Vol. 73, No. 6, November/December, pp. 62-78.
- Lawrence J. Lau and Huanhuan Zheng (2017), "How Much Slack Was There in the Chinese Economy Prior to Its Economic Reform of 1978?" China Economic Review, Vol. 45, September, pp. 124-142.
- W. Arthur Lewis (1954), "Economic Development with Unlimited Supplies of Labour," Manchester School of Economic and Social Studies, Vol. 22, pp. 139-191.
- Angus Maddison (2006), The World Economy: Vol. 1: A Millennial Perspective and Vol. 2: Historical Statistics, Paris: Development Centre of the Organisation for Economic Co-operation and Development.