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40 Book reviews on global economy and geopolitical readings

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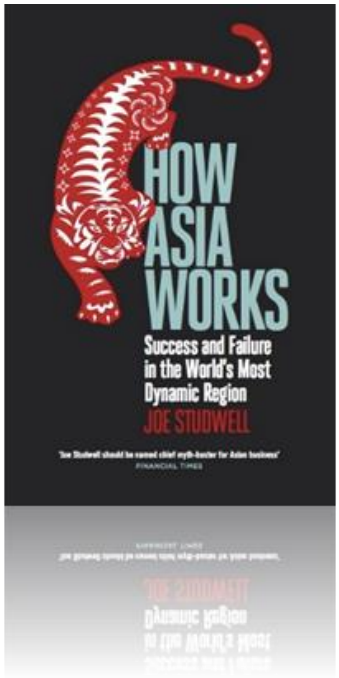
How Asia Works: Success and Failure in the World's Most Dynamic Region

Studwell, Joe, (2013), Profile Books, Great Britain.



"A historical review of East Asian economic development shows that the recipe for success has been as simple as one, two, three: household farming, export-oriented manufacturing, and closely controlled finance that supports these two sectors. The reason the recipe worked is that it has enabled poor countries to get much more out of their economies than the low productive skills of their populations would otherwise have allowed at an early stage of development."

"Neo-classical economists do not like political intervention in markets. They claim that markets are inherently efficient. But history shows that markets are created."

"The message that East Asia sends to economists is that there is no one type of economics. At a minimum there are two. There is the economics of development, which is akin to an education process… The economics of development requires nurture, protection and competition. Then there is the economics of efficiency, applicable to a later stage of development… The issue is not whether there are two kinds of economics that exist at different stages of development. The question is where these two stages met."

Summary

When the Asian Financial Crisis occurred in 1997, seven Asian economies — those of Japan, South Korea, Taiwan, China, Malaysia, Indonesia and Thailand— had been expanding at over 7% per annum for over a quarter century. By then, Japan had become a mature economy and faced a new set of structural problems of a post-development nature. South Korea, Taiwan and China, however, were still at the convergent stage of their economic development. These states were hardly affected by the Asian crisis and were soon once again chalking up high growth rates and making rapid technological progress. By contrast, Malaysia, Indonesia and Thailand's economic development stalled in its tracks.

In this book, Joe Studwell analyses the region's successes and failures and reveals that stunning economic grow rates concealed the fact that Asia is the continent with the greatest economic extremes. Half the region's players have achieved stunning

economic development while the other half have been shown to be 'paper tigers'. The author reveals: the considerable confusion and misunderstanding of the role government should play, as well as the different needs of emerging economies vis-à-vis developed ones. He stresses that governmental policies are what makes the difference between the short-term and the long-term economic success of these countries in three fields: agriculture, the manufacturing industry and finance. Failure is the fate in store for those countries that: (1) do not make land reforms; (2) exhibit rentier attitudes; (3) do not channel their investments towards industry.

The results set out are at odds with the laissez faire policies blithely advocated by economists and international bodies over the last few decades as drivers of rapid economic growth in the region. This has implications for non-Asian developing countries too. National polices, underlines the author, are what mainly determine a country's economic progress — not factors such as climate and geography.

The author

Joe Studwell is the founding editor of *China Economic Quarterly*. He has been working as an independent journalist for over twenty years. He has also worked with *The Economist Intelligence Unit*, *The Economist, The Financial Times, The Asian Wall Street Journal* and *The Far Eastern Economic Review*. He is author of *The China Dream* and *Asian Godfathers*.

Key ideas and opinion

In this book, Joe Studwell examines the success or failure of the swift economic transformations undergone by the main economies in Eastern Asia. To avoid watering down his main message, **the author omits financial centres and failed states from his analysis**, instead concentrating on those countries that attained modest success. The first group is an example of **rapid, sustainable development in North-Eastern Asia: Japan, South Korea, Taiwan and China**. The second group, in South-Eastern Asia comprises: **Malaysia, Indonesia, Thailand and The Philippines**. These nations had the same ambitions and resources as those in the first but **their rapid economic growth proved unsustainable over the long term**. For the author, the difference lies in the policies adopted by Asian countries in three critical areas: **agriculture, the manufacturing industry and finance**. The book is divided into these three sections.

The first mistaken policy (and whose folly is the most often overlooked), consists of **maximising agricultural production.** According to the author, those countries that have achieved success over the long term have shown that the right path is to **restructure their agriculture towards a labour-intensive family-based model**. This mobilises manpower in a poor economy, while boosting performance and production

as much as possible. The result is an initial excess of production, which stimulates demand for goods and services. The second step is to **channel investments and entrepreneurs into manufacturing industry**. The reason is that manufacturing makes the most effective use of unskilled manpower. The Asian countries that have achieved lasting success also fostered **speedy technological modernisation of the manufacturing industry, through state subsidies** awarded according to export results. The third step concerns the finance sector, which depends on the first two. Here, the strategy boils down to avoiding a short-term emphasis on individual consumption and instead **channels investment to key sectors that foster greater learning and long-term progress**. In the last part of the book, the author looks at the China's track record in the agribusiness and financial sectors. He stresses that if China fails to rise to the challenges posed by governance, institutional system and demography, its growth may stall.

Land: The Triumph of Market Gardening

Studwell begins this chapter by examining **the redistribution of farming land in Japan, South Korea, Taiwan and China at the end of the 1940s and early 1950s**. Land was a major political problem in Eastern Asia following the Second World War. Promises of land reform were crucial in Communist victories in China, North Korea and Vietnam. In Communist states, family-owned land would be collectivised for ideological reasons — a policy that stopped harvests rising and in many cases caused them to fall. In Japan, South Korea and Taiwan, redistribution of land to families was carried out in a peaceful, sustainable fashion. **In giving families proportionally equal plots of land, government policies created the conditions for near-perfect competition.** Furthermore, the redistribution policy was also combined with **complex infrastructural systems for boosting production, storage and commercialization.** In the absence of such infrastructure, it would have been hard for small-holdings to sustain the long rural booms that catalysed economic transformation — as can be seen from the economic difficulties that emerged in South-East Asia.

In **Malaysia, Indonesia, Thailand and The Philippines**, there was a great deal of debate in the post-war years on a fairer distribution of land and the provision of affordable loans in rural areas. Excellent reform programmes were launched. However, **South-East Asian countries ended up by making only minor reforms and focused on producing cheap food** for consumers rather than price increases in order to provide incentives for small-scale farmers. By contrast, North-East Asian countries took a 'root and branch' approach to land reform. For Studwell, this is where the divergence between the two *blocs* of nations began. The failure of leaders in the South-East to face agricultural problems made the path to development harder and foreshadowed other political blunders. Now, **60 years later, agricultural reform is still one of the main political problems in The Philippines, Indonesia, Thailand and — to a lesser extent — Malaysia**, where the nation's natural bounty mitigates low productivity.

Manufacturing: The Historian's Victory

In covering this second step and set of measures, the author analyses how **Japan, South Korea, Taiwan and China perfected ways of combining subsidies and protection for their manufacturing industry to foster competition and exports**, thus forcing firms to sell their products abroad and becoming internationally competitive. **Subsidies and loans were dependent on growth in exports. No state *largesse* was forthcoming for firms that failed to meet these objectives**. Indeed, such firms either had to accept mergers with more 'successful' companies, or go bust. Thus governments ended up creating leading world companies to justify state investment. This helped overcome the common problem with subsidies and protection policies — namely, that firms are often quick to take government money but slow (and even loathe) to develop competitive products. Studwell stresses that **although protectionism is inefficient in monetary terms, it fosters long-term industrial learning that makes it possible to acquire strategic knowledge at a temporary cost**.

In South-East Asia, entrepreneurs were no less capable than those in the North East. The difference was that governments in South-East Asia did not limit their activity to the manufacturing sector and failed to orient this towards exports. Instead, there were **state industrial projects in which there was no competition between firms and no pressure to export**. As a result, government investment policies yielded very poor returns. **The economic boom of the 1980s and 1990s hid the failure to create national industries and technological capacity**. **Large inflows of direct foreign investment** were mainly channelled into advanced manufacturing. **The crisis cruelly revealed the underlying weaknesses** of South-East Asian economies. Today, there are hardly any internationally recognised, competitive firms in South-East Asia. As the author sees it, Tiger Beer in Singapore and Singha Beer and Chang Beer in Thailand may be the only exceptions. **Without their own, successful brands, these countries remain technologically dependent on multinationals**.

Finance: The Merits of Strict Controls

After analysing the third step and its related measures, Studwell concludes that the financial structure of the successful Asian states is based on the need to obtain high yields in small-scale agriculture and to acquire manufacturing know-how. To these ends, financial systems in Japan, South Korea, Taiwan and China, were strictly supervised with tight control over international capital flows. These controls remained in place until these countries were far along the path to economic development. Conditional loans for exporting industry were the main resort to ensure the finance sector supported governmental policies. Firms wishing to borrow had to show that they had export orders. To fund development, interest rates were set at below market levels — something tantamount to a hidden tax that helped pay for the subsidies to agriculture and industry.

In South-East Asia, countries had the same saving rate as those in the North-East. **Governments in the former region, however, focused on sectors with low productivity; large-scale agriculture; and companies producing only for protected domestic markets or sectors irrelevant to the nation's economic development**, such as luxury goods, construction, and imports of consumer goods. These countries only **made things worse by following the advice of developed nations, deregulating their banking systems, opening the flood gates to other financial markets and lifting controls on capital movements**. Studwell argues that despite this deregulation, nothing was done to strengthen the financial system and make it more useful and sustainable. The same advice was tendered to nations in North-East Asia in their initial development, but these turned a deaf ear to this siren song for as long as they could.

Premature deregulation in South-East Asia led to a spate of banks controlled by business families who did nothing to support the export-oriented manufacturing industry, preferring to make shady loans to other sectors. The story is one of **banks 'captured' by private interests whose aims are at odds with the country's strategic development policies**. The same process was seen in Latin America and Russia.

Where China fits in

Deng Xiaoping's assumption of power in 1978 led to the restoration of family farming, thus recognizing the inefficiency and unpopularity of the nation's vast communes. By the beginning of the 1980s, the country's agricultural production had risen by a third, all thanks to family farming. **By the end of the 1990s, China had a cereal surplus of 500 million metric tonnes. At the same time, China gradually opened up to foreign trade and investment.** This let the country absorb foreign technology and begin launching its own products in international markets. Moreover, China was able to do this largely on its own terms, despite receiving the technical advice and financial assistance of international organizations such as the World Bank and the IMF in the 80s and 90s (just as the rest of the South-East Asian countries did).

As elsewhere in East Asia, **China strongly fostered exports, which were overseen by state planning agencies.** These included the **China Development Bank**, which was (and is) the main funding and inspection body. Furthermore, the government retains control over service companies and those engaging in pre-manufacturing activities. Such firms, in South-East Asia, fell into the hands of magnates whose interests were at odds with industrialisation policies. **China's approach soon yielded fruit. The economy took off and firms became internationally competitive** (in mining equipment, construction machinery, shipbuilding, power generation (hydro-electric, wind, thermal) and telecommunications infrastructure, amongst others). The financial sector (as in the cases of Japan, South Korea and Taiwan) allowed the implementation of effective policies for agriculture and manufacturing industry.

Even so **there are barriers to growth that China needs to overcome if its economy is not to stall.** The author argues that China should go back to **fostering merit and getting results**. Studwell criticises China's political elite for feathering its own nest and of being increasingly reluctant to impose tough (and unpopular) economic policies. Unfortunately, **the country's growing wealth has not made reforms any less necessary** — a situation that recalls Japan in 1980. Indeed, the author believes that even if China manages to avoid a financial crisis over the next decade, a new demographic policy will be needed to tackle China's greying population. The bright side is that the population's disposable income is growing. As a result, the gap between productivity gains and salaries that opened up over the last few decades is beginning to narrow. Last but not least, **China must not only develop its technology but also its institutions. Failure to do so will give wings to social unrest which, while it has not hindered growth so far, could yet prove costly.**