

Authority and Academic Scribblers

*The Role of Research in
East Asian Policy Reform*

EDITED BY SYLVIA OSTRY



INTERNATIONAL CENTER FOR ECONOMIC GROWTH
NATIONAL CENTRE FOR DEVELOPMENT STUDIES OF AUSTRALIAN NATIONAL UNIVERSITY
ECONOMIC DEVELOPMENT INSTITUTE OF THE WORLD BANK



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ICS Press
San Francisco, California

Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back.

—John Maynard Keynes

PREFACE

Authority and Academic Scribblers presents a glimpse of the nuts and bolts of economic policy making in eight East Asian countries. In examining the role of policy research in formulating economic policy, *Authority and Academic Scribblers* responds to the growing interest in both the relationship between the academic and legislative bodies and the rapid economic growth achieved by some East Asian countries.

This volume sheds light on the types of policies most conducive to growth and the types of governmental and nongovernmental organizations most effective at conceiving and implementing such policies. In many countries the work of policy researchers fails to meet the needs of policy makers, and the authors suggest how to deal with this and other difficulties.

The International Center for Economic Growth is pleased to copublish this book with the National Centre for Development Studies of Australian National University and the Economic Development Institute of the World Bank. Because the dissemination of innovative and useful policy research, as well as the effective communication of policy ideas, is the primary purpose of ICEG, *Authority and Academic Scribblers* is of great importance to the Center. We hope that all who carry out or use policy research will benefit from the analysis in this volume.

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General Director

International Center for Economic Growth

March 1991
Panama City, Panama

ACKNOWLEDGMENTS

These papers were initially developed at a workshop in December 1988 by a small group of scholars working on the economics of liberalization in their own countries. A Senior Policy Seminar, moderated by Sylvia Ostry, followed in March 1989, with politicians and government representatives from East Asian countries participating in a lively discussion.

The Economic Development Institute of the World Bank, in particular Sid Chernick, Vinyu Vichit-Vadakau and Hyung Ki Kim, planned the workshop and seminar.

The National Centre for Development Studies hosted both the workshop and the seminar in Canberra. Brian Brogan was the project manager, Maureen Liu the administrator. Margaret Callan edited the original drafts. Centre staff, notably Maree Tait, May Stinear, and Rae Fry, prepared the papers for publication.

I thank all those who contributed to the success of the meeting and the preparation of the book.

Helen Hughes
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CONTENTS

Chapter 1	Introduction: Research and Economic Liberalization <i>Sylvia Ostry</i>	1
Chapter 2	The Role of Policy Research in the Trade and Industry Reforms of Thailand <i>Narongchai Akrasanee</i>	7
Chapter 3	Managing Trade and Industry Reforms in Malaysia <i>Mohamed Ariff</i>	23
Chapter 4	Evolution of Reforms and Structural Adjustment in the Korean Economy <i>In June Kim</i>	45
Chapter 5	Trade and Industry Reforms and Policy Research in China <i>Zhao Dadong</i>	59
Chapter 6	Trade and Industry Reforms in the Philippines, 1980–1987 <i>Raul V. Fabella</i>	73

Chapter 7	Managing Economic Policy Reforms in Indonesia <i>Mari Pangestu</i>	93
Chapter 8	Financial Liberalization in Australia and New Zealand <i>Suiwah Leung</i>	121
Chapter 9	Conclusion <i>Sylvia Ostry</i>	151
	<i>Notes and References</i>	159
	<i>Participants</i>	169
	<i>Contributors</i>	173
	<i>Index</i>	175

TABLES AND FIGURES

Table 2.1	Share of Gross Domestic Product by Sector, 1960–1987	10
Table 2.2	Manufacturing Output by Sector	11
Table 2.3	Imports by Economic Classification	12
Table 2.4	Share of Exports by Sector	12
Table 2.5	Share of Exports by Product	13
Table 2.6	Net Private Foreign Direct Investment by Industry	16
Figure 3.1	Planning, Coordination, and Evaluation	37
Figure 3.2	Planning Process	37
Table 5.1	Value and Growth of Foreign Trade, 1979–1987	61
Table 5.2	Growth of Rural Industries, 1981–1987	65
Table 6.1	Distribution of Tariffs by Nominal Rate	76
Table 6.2	Average Statutory Tariff Rates	76

Table 6.3	Average Effective Rates of Protection	77
Table 6.4	Number of Items Regulated, Banned, and Liberalized, 1980–1986	78
Table 6.5	Summary of the Board of Investment Fiscal Incentives, 1986	79
Table A6.1	Macroeconomic Statistics 1975–1985	90
Table A6.2	Debt Statistics, 1975–1985	91
Table 7.1	Economic Reforms	96
Figure 7.1	Policy-Making Organization and Inputs	100
Table 7.2	Reforms and Effects, 1983–1988	105
Table 7.3	Financing Sources of the Development Budget, 1969–70 to 1987–88	107
Table 8.1	Interest Rates in Australia, 1970–1987	126
Table 8.2	Market Share of Banks in Australia and New Zealand, 1967–1986	127
Figure 8.1	Assets of Australian Savings Banks, Credit Unions, and Building Societies as a Percentage of Their Total Assets, 1964–1986	128
Figure 8.2	Real Effective Exchange Rate of New Zealand, 1980–1988	135
Figure 8.3	Real Effective Exchange Rate of Australia, 1980–1988	138
Table 8.3	Exchange-Rate Volatility	140
Figure 8.4	Australian Cash Interest Rates, August to October 1983 and August to October 1985	141

INTRODUCTION: RESEARCH AND ECONOMIC LIBERALIZATION

Since the 1960s the rapid economic growth in East Asia has been the focus of a great deal of attention throughout the world. This book responds to the interest in these countries by exploring the contribution of specific economic policies to the countries' dramatic growth and then by investigating the role of research in formulating economic policy.

The enormous success enjoyed by a group of East Asian countries is truly extraordinary, outpacing all developing countries in economic growth and social development. In the 1950s the Republic of Korea and Thailand were among the poorest countries in the world; they are now "middle-income countries." The East Asian industrializing countries and near-industrializing countries are catching up to the industrial countries in productivity and living standards. If all industrializing countries were growing at their pace, development would not be a problem. There would be far fewer poor people in the world, and the great differences between developing and industrial countries would disappear.

This remarkable economic growth is, to a large degree, the result of successful economic policies. Conservative fiscal and monetary policies, which have been more consistently applied in several East Asian countries than in developing countries elsewhere in the world, have resulted in low inflation, stable exchange rates, and microeconomic policies that tended toward outward rather than inward orientation. Compared with economic policy in South Asian and Latin American countries over the

past thirty years, economic policies in East Asia have also been less inclined toward public ownership of production outside the natural monopoly, public goods sectors.

The Role of Research in Policy Formulation

In East Asian countries, policies are determined, as they are in all countries, by the interactions of politicians, bureaucrats, and special interest groups of varying degrees of power and competence. This political process has shaped the world's economic successes, as well as its failures, over the past thirty years. Although most of the East Asian countries are not democracies in the European-North American mold, political power does depend on some degree of popular support. And although the policy formulation debate has not been as open as it has been in industrial democracies, it has taken place. (The principal exceptions are China and Vietnam, where technical economic expertise lags far behind most other East Asian countries.)

Research has made a major contribution to the outcomes of policy formulation debates by informing the process within bureaucracies, political arenas, and special interest groups and throughout public debate in the region.

Research reduces the likelihood of ad hoc responses to problems. Using the results of research, decision makers can identify the key economic problems facing a country, formulate a range of policy options, and articulate possible policy responses together with their consequences.

Policy choices and combinations of policies can be improved by

- clearly defining the problems faced
- setting out the principal alternatives available
- clearly identifying the major vested interests likely to be affected by policy changes
- comparing the cost effectiveness of various policies and groups of policies
- ascertaining the trade-offs among policy choices and hence providing a basis for negotiation among vested interests

It is also essential to consider both *structural* issues (such as the allocation of policy oversight to various government departments) and *process* issues (such as cabinet committee and consultative systems).

Successful Policy Research

Some types of research are more useful than others in successful policy formulation. The characteristics of useful economic research are not difficult to define:

- A reasonable database is needed, but data gathering must be cost effective rather than exhaustive; the database must be in the public domain to ensure that it is widely used and hence constantly checked.
- Research needs a sound theoretical base rather than an ideological bent.
- Technical tools must be rigorously used to test alternative policy possibilities.
- An independent institutional base is required for effective research inputs.
- An open debate must ultimately emerge to subject research to domestic and international peer review.

No matter how advanced the theory, how strong the database, or how sophisticated the modeling techniques, the research process also requires good judgment.

During the past thirty years or so most East Asian countries have developed economic policy research capacities that meet such standards. Most have relied heavily on training students abroad (initially at undergraduate and more recently at graduate levels). Returning students staffed universities, bureaucracies, and research organizations. Initially, countries also relied on assistance from research organizations in industrial countries. Harvard University, the University of Wisconsin, the Rockefeller and Ford foundations, and many other universities and research organizations played an important role in building up professional and research skills in East Asian countries.

Although the governments of East Asia devoted considerable resources to economic planning (all of the East Asian countries except Hong Kong had formal five- to seven-year plans for some time at least), planning contributed surprisingly little to building research capacity. Most East Asian countries became dubious about the utility of planning by the 1970s, but paradoxically, they continued to produce plans to satisfy donors. The principal contribution of planning was in the introduction of rigorous cost-benefit methodologies to rank public works

projects. Thus, planning *de facto* combined strategic statements about the direction of growth with public-sector expenditure plans.

The failures of economy-wide planning led to the establishment of a new type of research unit, which focused on policies that lead an economy by price signals to producers and consumers rather than by physical directives. Specialized policy research units, with strong overseas support through staffing and funding, followed the example of the Korea Development Institute (KDI). To retain a well-trained professional and support staff, KDI-type institutes increased low salaries at universities and continued to sponsor both travel abroad by Asian scholars and visits to East Asia by leading overseas economists.

Policy Research and Economic Liberalization: Overview

This volume grew out of a seminar attended by politicians, bureaucrats, and academics from East Asia, Australasia, and international organizations in Canberra, Australia, in March 1989. They discussed their experiences with the liberalization process and the role of policy research in successful development. The background papers and the conclusions of the discussion appeared to be sufficiently novel to merit publication.

The volume begins with chapters on Thailand, Malaysia, and Republic of Korea. Because of their remarkable economic growth, there is perhaps more interest in these three countries than in any of the other five examined in this book. Each of the three, however, has had its own experience with policy research.

Narongchai Akrasanee discusses the role of policy research in Thailand, where well-educated technocrats have been in government posts since the 1960s when economic growth began to accelerate. Macroeconomic policies have been the foundation on which agriculture, industry, and trade could develop. When the research inputs were found to be inadequate for a rapidly growing economy in the 1980s, the Thai Development Research Institute was founded.

Mohamed Ariff discusses the influence of policy research in Malaysia. Malaysia has never had severely distorted economic policies. Consequently it has not required radical policy adjustment. Policy research has not been strong in Malaysia: among the factors responsible have been a lack of interest in research on the part of policy makers and the abstract nature of the research done by academic economists.

Policy reform in the Republic of Korea is discussed by In June Kim. He notes that recently the Presidential Commission on Economic Restructuring established a forum for public debate on economic issues. Commission members came from a broad spectrum of society to inves-

tigate a variety of issues. An underlying contribution, however, came from the Korea Development Institute, which established the importance of research for policy reform not only for the Republic of Korea, but for the entire region.

Zhao Dadong discusses the role of policy research in China, which, like the other countries discussed in this book, instituted major economic reforms in the 1980s. Unlike the other countries, however, China had a centrally planned economy. Because the interest in, as well as the practice of, economic research is relatively new in China, there is a shortage of adequately trained researchers and an insufficient database. Chinese policy makers are taking time to understand the importance of an open policy debate for the effective utilization of research in policy making.

Raul V. Fabella discusses the role of research in policy reform in the Philippines, where political, social, and economic circumstances have been quite different than in most East Asian countries. Economic policy began with high levels of protection in the 1950s and then moved to stop-and-go macroeconomic policies. Economic debate was repressed by the government of Ferdinand Marcos and was often distorted by the media. Fortunately Filipino academic economists provided an independent critique of the economic policies of the Marcos government, and they have continued to attempt to influence and stimulate economic reforms under Corazon Aquino's government.

Mari Pangestu points out that in Indonesia the high level of petroleum income was too much of an obstacle to economic reform. The fall in petroleum prices, however, stimulated policy reforms in the 1980s so that the Indonesian economy has performed much better than that of other petroleum-rich countries. Indonesia has been fortunate in having a stable group of policy makers, who were not only concerned with the content of reforms but also with their appropriate sequencing. The importance of public debate has recently been recognized as an important component of policy formulation.

Suiwah Leung illustrates the necessity of support from the private sector in a market economy. In Australia and New Zealand financial liberalization became the starting point for further policy reform. In both countries the economy changed, making liberalization desirable and creating a political climate conducive to change. Ultimately there was little opposition to Australasian financial liberalization because most of the parties involved benefited from it. Public institutions in Australia and New Zealand carried out much of the research necessary for financial liberalization to take place. Nevertheless, there has been strong theoretical support from the academic community, and in the second half of the 1980s a number of think tanks have developed to stimulate the debate, which has also benefited from a strong financial press.

THE ROLE OF POLICY RESEARCH IN THE TRADE AND INDUSTRY REFORMS OF THAILAND

During the past three decades Thailand has had a stable economy and reasonable growth by international standards. The industrial sector, led by manufacturing, has expanded substantially. There has been expansion in manufactured exports since the early 1970s, and significant increases since the mid-1980s. In recent years the country has had substantial foreign-investment inflows and foreign-exchange earnings through tourism and other service incomes.

Before 1960 Thailand had a small manufacturing sector comprised of relatively large-scale government enterprises and mostly small-scale private enterprises. After 1960 incentives for private investment were introduced, and the government concentrated on providing public infrastructure. Economic growth accelerated: the manufacturing sector expanded as a protective tariff regime and investment incentives promoted import-substituting industries. In the 1970s the policy emphasis moved more toward export promotion, and by 1987 manufactured exports were 63 percent of total exports.

After the 1973 petroleum price increases, Thailand's growth rate fell and inflation rose. Nevertheless, with expansionary macroeconomic policies and improving world economic conditions, real growth rates recovered to average 9 percent per year in the period 1975-1978. The second round of petroleum price increases had more serious consequences because Thailand had become more dependent on external trade. Inflation

accelerated, the balance-of-payments deficit rose, and the burden of debt servicing increased. Slower industrial growth followed. By 1986, however, an export-led recovery was under way. Domestic prices and interest rates were adjusted downward, investment and tourism were promoted, and domestic economic activity expanded. Foreign investment in Thailand increased rapidly, especially in the export sector.

Until the 1980s Thailand's economic growth was directed through macroeconomic policy. The tariff structure and investment incentives protected the developing industrial sector. Regardless, there were major policy reforms after the second petroleum price increase, when the cost of imports rose dramatically and the government had to borrow heavily abroad. First, the baht was devalued and tied to a basket of currencies rather than the U.S. dollar. Second, the private sector was encouraged by liberalization of business practices. Third, industrial policy emphasized the export sector through promotion activities, tax rebate and refund schemes, and changes to the tariff structure.

As a result, the economic situation has turned around rapidly since 1986. Economic growth has accelerated, export earnings have expanded, and foreign exchange from tourism and investment have helped to alleviate the country's external balance problems. Although some basic economic problems such as rural poverty and disparity in income distribution remain to be solved, it is widely believed that Thailand's overall economic performance will continue to be strong. Some predict that Thailand will join the newly industrializing countries in the 1990s.

The military dominated Thailand's government until recently. Decision making was a closed process, and there was little coordination between government agencies. Since 1980, however, elected politicians have been more important, and the prime minister has appointed a number of technocrats to the cabinet and some academics to be economic advisers. These professionals are open to advice from outside, and there has been much public debate on policy issues. Because Thailand has relied mainly on macroeconomic policy to direct its trade and industry development, policy research has been done overwhelmingly by government agencies. At present there seems to be a demand from policy makers for more independent research. Cooperation between government and independent policy researchers is desirable.

This chapter reviews the industrialization process in Thailand in the last three decades, with an emphasis on trade and industrial policy reforms and the role of policy research in this process. First, there is a historical background of industrial development in Thailand over the past three decades. Second, a description of industrial and trade policy reforms. Third, a discussion of the role of policy research in policy reforms and conclusions about the lessons learned.