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SECTOR STUDIES

Private Sector Development and Enterprise Reforms in Growing Asian Economies

Seiji Naya

International Center
for Economic Growth

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PREFACE

We are pleased to publish this monograph by Seiji Naya as the third in our Sector Studies series. A Sector Study may analyze one country's response to a specific policy problem or compare the policies of several countries. This Sector Study looks at the growing economies of Asia and their responses to the changing international environment, focusing on the role of government, private enterprise, and entrepreneurs.

The developing countries of Asia continue to demonstrate strong economic growth. They present an example to the rest of the developing world that enterprise promotion and economic liberalization can lead to technological innovation, increased production levels, and overall economic efficiency.

Seiji Naya examines the decisions and strategies formulated by the industrialized and industrializing countries of Asia in response to new information about market-oriented economies, changes in the international environment, and their need to reduce government spending. This comparative analysis provides a look at the different ways governments have defined economic policy and cooperation with entrepreneurs to promote capital formation, entrepreneurship, industrial growth, and exports.

This work presents a timely and important contribution to the literature of development economics. It is our hope that developed and developing countries alike will benefit from the lessons derived from the experience of these countries and that their successes will encourage policy makers and entrepreneurs everywhere to work together toward economic growth, efficiency, stability, and human development.

Nicolás Ardito-Barletta
General Director
International Center for Economic Growth

Panama City, Panama
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The views and opinions expressed here are strictly those of the author and do not necessarily reflect those of the East-West Center or any other institution.

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Introduction

The success of the developing countries in Asia offers a tremendous contrast to the difficulties confronting countries in other developing regions, such as Latin America. For developing countries in general, the 1980s were especially difficult years. Average growth was cut in half, from nearly 6 percent in the 1970s to about 3 percent (see Table 1). The Asian developing countries, by comparison, continued to maintain growth rates averaging 6 and 7 percent, and this relatively strong economic performance is expected to continue. They will continue to grow faster than the average for all developing countries. Indeed, because of their strong economic performances, other developing countries have begun to look at some of the Asian countries as development models.

The newly industrialized economies (NIEs)—Hong Kong, Korea, Singapore, and Taiwan—have followed the example of Japan and clearly demonstrated the benefits of outward-looking, market-based development policies. Their per capita incomes grew at phenomenal rates, averaging more than 6 percent over the past twenty-seven years (see Table 2), while their share of world exports increased from less than 2 percent to nearly 7 percent over the same period. Other Asian countries are following the example set by the NIEs and have adopted policies to liberalize trade, promote exports, and develop enterprise potential in a general movement toward market-oriented development strategies. The resource-rich member countries of the Association of Southeast Asian Nations (ASEAN-4)—Indonesia, Malaysia, the Philippines, and Thailand—were among the first to adopt this policy orientation. Malaysia and Thailand, in particular, are seen to be on their way toward achieving the stature of NIEs. Although

TABLE 1 World Output, 1970–1989 (annual percentage change)

	Average 1970–79[a]	1980	1981	1982	1983	1984	1985	1986	1987	1988[b]	1989[b]
World	4.1	2.2	1.7	0.5	2.7	4.5	3.4	3.2	3.2	3.8	3.1
Industrial countries	3.3	1.4	1.5	–0.3	2.8	5.0	3.3	2.7	3.3	3.9	2.8
United States	2.8	–0.2	1.9	–2.5	3.6	6.8	3.4	2.8	3.4	4.0	2.8
Other industrial countries	3.7	2.3	1.3	1.0	2.3	3.7	3.3	2.5	3.3	3.9	2.9
Japan	5.2	4.3	3.7	3.1	3.3	5.0	4.8	2.5	4.2	5.8	4.2
West Germany	3.1	1.5	na	–1.0	1.9	3.3	1.9	2.3	1.8	2.9	1.9
Developing countries	5.7	3.4	1.8	1.7	1.9	4.0	3.5	4.2	3.4	3.6	4.0
Median growth rates	5.1	3.7	3.0	1.7	1.5	2.9	3.1	3.4	2.7	3.0	3.5
By region											
Africa	4.4	3.6	2.0	1.2	–1.3	0.8	3.7	2.1	2.3	2.6	2.8
Asia	5.4	5.5	5.8	5.2	7.6	7.8	6.3	6.4	6.8	7.3	6.3
Europe	5.6	0.1	na	1.1	1.9	4.3	2.4	4.1	2.5	2.6	2.8
Middle East	7.3	–2.5	–2.1	0.2	0.9	–0.2	–1.1	2.2	–0.5	0.9	1.8
Western hemisphere	5.7	6.0	0.2	–1.1	–2.4	3.5	3.5	3.9	2.5	1.4	3.4
By analytical criteria											
Fuel exporters	7.1	0.9	0.9	0.1	–1.0	0.6	1.2	1.0	0.6	1.2	2.3
Nonfuel exporters	5.1	4.3	2.2	2.4	3.3	5.7	4.7	5.7	4.6	4.5	4.6
Market borrowers	6.1	5.0	1.9	0.4	–0.4	3.5	3.2	4.2	3.6	2.8	3.9
Official borrowers	3.5	2.9	3.1	2.4	1.8	2.5	3.0	4.0	3.3	5.2	4.2
Other countries[c]	5.5	4.0	2.7	2.6	3.4	3.2	3.4	4.1	2.6	3.4	3.1

NOTES: na = not available.

Real GDP (or GNP) for industrial and developing countries and real net material product (NMP) for other countries. Composites for the country groups are averages of percentage changes for individual countries weighted by the average U.S. dollar value of their respective GDPs (GNPs or NMPs where applicable) over the preceding three years. Because of the uncertainty surrounding the valuation of the composite NMP of the other countries, they have been assigned—somewhat arbitrarily—a weight of 15 percent in the calculation of the growth of world output.

a. Compound annual rates of change, excluding China.

b. Estimate.

c. The USSR and countries of Eastern Europe that are not members of the International Monetary Fund.

SOURCE: International Monetary Fund, *World Economic Outlook*, October 1988.

these countries have lower per capita incomes than the more affluent NIEs, they grew faster than most other developing countries in the 1970s. The depressed commodity and oil prices of the 1980s slowed growth, but the continued emphasis of these countries on outward-looking policies and enterprise reforms has helped them counter some of the adverse effects. This success can be seen by the improvement in growth rates in the late 1980s.

Various measures to liberalize the economy and reform enterprises have also been adopted in South Asia. Partly as a result of these policies, the growth rates of several South Asian economies have been quite impressive. In particular, India, the largest country in the region, has surpassed its historically moderate growth rate of 3.5 percent and posted gross domestic product (GDP) growth of about 5 to 6 percent a year in the 1980s. Pakistan, another important country in the region, also maintained high growth in the 1980s, averaging 7 percent a year. Low domestic saving rates and a high debt burden continue to plague Pakistan's development efforts, but privatization efforts, movements to improve the efficiency of public enterprises, and an overall market-oriented strategy toward development have contributed to vigorous growth of the private sector there.

The most notable economic reforms are those now under way in China. These reforms will not only affect China internally, but also will affect the entire Asia-Pacific region for years to come. Since 1978, reforms have been introduced in agriculture, industry, and foreign trade. China has discovered that socialism does not necessarily have to be synonymous with "planning," and that private initiative can be used to increase efficiency. The successful introduction of the household responsibility system in agriculture saw farm production grow impressively, and the infusion of foreign capital and imports led to improvements in technology and export earnings. Although enterprise reforms in the industrial and manufacturing sector have been slow to come and difficult to implement, China appears to have recognized the importance of these reforms in accelerating its industrial production and spurring economic growth.

In view of these examples, a majority of the countries in the Asia-Pacific region have moved toward more market-oriented policies emphasizing private sector development and enterprise reform. This growth strategy essentially argues for a greater reliance on impersonal market forces to allocate resources, but the concept of enterprise reform and private sector development varies from country to country, as do socioeconomic conditions and social objectives. At the most basic level, there

TABLE 2 Average Annual Rates of Growth of Real GDP and Real GDP per Capita

Group/country	Real GDP 1960–69[a]	Real GDP 1970–79[b]	Real GDP 1980–87[c]	Real GDP 1988[d]	Real GDP per capita 1960–87[e]
NIEs					
Hong Kong	10.0	9.4	8.1	7.5	6.1
Korea	8.5	9.8	7.2	11.0	6.5
Singapore	8.9	9.6	6.4	10.1	6.5
Taiwan	11.6	10.1	7.4	7.0	7.4
ASEAN-4					
Indonesia	3.5	7.7	5.1	4.0	3.2
Malaysia	6.5	8.1	5.0	7.4	3.7
Philippines[f]	4.9	6.3	1.0	6.4	1.4
Thailand	8.3	7.0	5.1	9.1	4.1
South Asia					
Bangladesh	na	6.7	3.7	2.6	2.6
Burma	3.5	3.6	5.4	na	1.8
India	3.7	3.2	5.5	8.1	1.7
Nepal	1.5	2.5	3.0	7.0	–0.1
Pakistan	5.0	3.7	7.1	6.1	5.4
Sri Lanka	4.8	5.7	5.0	3.6	3.2
Other Asia					
China[g]	2.9	7.5	9.2	8.5	4.5
Developed countries					
Australia	5.1	3.3	3.4	3.0	2.2
Canada	5.7	4.7	2.9	na	3.1
Japan[f]	12.1	5.2	3.9	5.8	6.3
New Zealand	4.1	2.2	2.2	na	1.6
United States[f]	4.1	2.8	2.3	3.8	2.0

NOTES: na = not available.

a. 1961–69 for Singapore, Indonesia, and India; 1962–69 for Canada.

b. 1971–79 for Malaysia; 1974–79 for Bangladesh.

c. 1980–85 for New Zealand; 1980–86 for Indonesia, Burma, India, and Sri Lanka.

d. Preliminary estimates.

e. 1960–85 for New Zealand; 1960–86 for Burma and Sri Lanka; 1961–86 for Indonesia and India; 1961–87 for Singapore; 1962–87 for Canada; 1967–87 for Hong Kong; 1971–87 for Malaysia; 1974–87 for Bangladesh.

f. Real GNP and GNP per capita.

g. Real national income and national income per capita.

SOURCES: Asian Development Bank, *Key Indicators of Developing Member Countries of ADB*, April 1983 and 1984, and July 1987 and 1988; *Far Eastern Economic Review*, March 2, 1989; International Monetary Fund, *International Financial Statistics*, Yearbook 1987 and 1988, and August 1988; Project Inter-Link, November 1988; Republic of China, Council for Economic Planning and Development, *Taiwan Statistical Data Book 1988;* World Bank, *World Development Report 1982*.

is ambiguity about what constitutes the private sector; the distinction between the public and the private sectors is often blurred. The ambiguity stems from the fact that the private sector is affected and influenced by a wide range of policies and conditions such as macro policies, sector issues, foreign investment policies, the function and scope of small-scale firms, and the legal and regulatory framework. At the same time, the way these policies affect private sector development varies from country to country.

These strategies are not without their defects. It is therefore necessary to spell out more clearly the areas in which the private sector has the comparative advantage over other institutional mechanisms in organizing production and exchange. Some particular areas of interest include the role of the private sector in risk intermediation and innovation, as well as its ability to respond to changing market conditions, both at home and abroad, by a continuous adoption of new and least-cost techniques of production.

It is important to broaden our understanding of what is involved in enterprise reform and the general movement to increase the role of the private sector in Asian developing countries. We need to examine possible measures that can be used to foster private sector development, increase competition, and promote efficiency in the economy. There are several alternatives—including privatization of state-owned enterprises, deregulation of industries, separation of control from ownership, and liberalization of trade policies and financial markets—which, if done simultaneously, can increase efficiency and productivity.

Of these alternatives, the most visible policy initiatives have involved enterprise reforms, including privatization of some state-owned enterprises. Because of the operational inefficiencies and financial dependence of many state-owned enterprises, a growing interest in enterprise reforms is evident in Asia—from countries with free-enterprise economies such as Hong Kong to those with planned economies such as China—as more and more state-owned enterprises come under increasing scrutiny. Before a decision is made to undertake reforms in state-owned enterprises, however, many issues should be considered in terms of objectives and the general criteria to be used. Further, once the decision is made to privatize or reform an enterprise, it is important to consider the methods and procedures, the terms and conditions, and the benefits and costs associated with the change. At the same time, a clear distinction must be made between government and public enterprises. The latter are a separate entity and the degree of control the national governments have over them varies from country to country.

In Chapter 2, the traditional justification for government involvement in an economy is discussed, at both the macro and the micro levels. It is interesting to note that some of these traditional arguments are no longer relevant or have been significantly weakened by changes in technology or the world environment. Chapter 3 examines the new role of a modern *government and the emerging importance of the private sector.* Chapter 4 *discusses national policies that affect private sector development.* These include macro policies (fiscal, monetary, and trade policies) as well as sectoral and institutional policies that can promote private sector development. Chapter 5 offers a comprehensive discussion of the role of markets and private enterprises. Chapter 6 looks at state-owned enterprises, in both market and nonmarket economies, and raises issues dealing with the continuing reform of these enterprises. Chapter 7 examines the privatization issue. Chapter 8 elaborates on what the individual Asian developing countries have done in the area of enterprise reform. The final chapter offers some concluding thoughts.

2
The Traditional Role of Government

As mentioned in the Introduction, various factors contributed to active government participation in the developing countries in the period immediately following the Second World War. It is a well-known proposition that under certain circumstances a market economy may not be able to produce the most efficient and appropriate mix of goods and services because prices sometimes fail to provide the correct signals to consumers and producers. Accordingly, these concerns have motivated governments to intervene in their own economies. Government's role in social and economic development continues to be seen as pivotal. What has become clear is that government can play two very different roles: (1) a promotional, market-based role, or (2) an overtly interventional role that pays little attention to markets and prices.

Macroeconomic Justification for Government Intervention

At the end of the Second World War, a new international order emerged in which the newly found political independence of many developing nations brought with it a desire for economic independence. Rapid industrialization of the domestic economy was believed to be the key to

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This chapter draws heavily from a paper by the author entitled "Private Sector Development for Promoting Economic Growth in Asian Developing Countries," (Report prepared for the Regional Bureau for Asia and the Pacific, United Nations Development Program, February 1988).