



Asia-Europe Institute

University of Malaya



10

International Workshop

New perspectives on Asian Epistemologies: Japan

PANEL III – BALANCING RESPONSIBILITIES
23 SEPTEMBER, 2003

**Domestic institutions as the most important source of
development**
by

Mr Duong Quoc Thanh

Email: bimben_99@yahoo.com

Asia-Europe Institute, University of Malaya

50603 Kuala Lumpur, Malaysia

Tel : 03-7967 4645 / 03-7967 6910 / 03-7967 6921 Fax: 03-7954 0799 E-mail: asia_euro@um.edu.my

<http://www.asia-europe-institute.org>

Domestic institutions as the most important source of development

Duong Quoc Thanh
Institute for International Relations, Hanoi

I. Introduction

The discourse of development has been influenced in significant ways by the success of Asian economies, starting with Japan in the 1960s, the NICs in the 1980s and then ASEAN in 1990s. In a much debated publication of the World Bank in 1993 entitled “The East Asia miracle” the authors argued that state role in applying neo-classical economic policy was the key for the success of the economy of those countries. Why states in East Asia can play such a supportive role for the market to function smoothly as contrast to the tension between state and market in Western countries? The answer seemed to lie with cultural factors such as Asian values which prioritize community over individual. Asian epistemology, if there is one, seems to be non-positivism and holism as compared to the positivism and individualism that predominate Western epistemology.

With the financial crisis in 1997 and the weak regional response to manage it, the debate on Asian values have lost steam and discourse on development once again turned back to the IMF conditionality. The crisis, in retrospect is a blessing in disguise. East Asian regionalism has come on strong since 1997 most importantly from the common realization that regional issues must be dealt with by regional institutions.

One strong indicator of regionalism in East Asia is the trend to set up Free Trade Areas first among ASEAN and then between ASEAN and China and Japan, South Korea may possibly follow suit. In this paper, however I will argue that efforts towards regionalism

by way of free trade should not crowd out efforts at home to build strong domestic institution for development. In this respect, Asians can learn from their neighbors, most importantly from Japan lessons both of success and failure.

II. The Asian Values Revisited

In the height of Asian economic success during the early years of the 90 decade, the conception that what lies behind all this is Asian values was articulated and publicized by Prime Minister Lee Kuan Yew of Singapore . In an interview with the Foreign Affairs in March/April 1994, Lee Kuan Yew argued that Eastern societies, unlike Western ones “believe that the individual exists in the context of his family” and “the family is the building brick of society”. In Asia, Lee asserted, “the ruler or the government does not try to provide for a person what the family best provides”. This family-oriented culture, according to Lee, is the main cause of East Asia’s economic successes. He further argued that the Western political system, with its intrusive government is not suited to the family-oriented East Asia.

Lee’s cultural arguments prompted two important responses, one from a famous American economists, Professor Paul Krugman and the other from a then South Korean dissident who later became the country president Kim Dae Jung. Krugman argued that Asia’s miracle is a myth and the Asian tigers are just papers. The rise of Asian economy, according to Krugman was fueled by mobilizing resources- increasing inputs of machinery, infrastructure and education like the Soviet Union in the past. As if to

respond directly to Lee, Krugman went so far as to say that "Singapore's boom is the virtual economic twin of Stalin's U.S.S.R".¹

Kim Dae Yung, the politician, responded in a different way. Rejecting Les's suggestion that "Western concepts" of democracy and human rights will not work in Asia, Kim posited that Asian has its own venerable traditions of democracy, the rule of law and respect for the people. Asia destiny, therefore is to "improve Western concepts, not ignore them"².

When the financial crisis hit Asia tigers in 1997, blames were on "crony capitalism", corruption, unsound macro economic policy, the bulk of which can be attributed to Asian values. It's amazing to see how a chief savior turned into a chief culprit in such a short period of time. People quickly forget about the debate on Asia values and turn to the task of reviving Asian economies. In retrospect, however, we might notice that the failure of Asian economies in the 1997 crisis had an important cause: domestic institutional weakness and institutions have many cultural elements in them.

III. The surge of regionalism and the free trade fever.

The 1997 financial crisis has revealed the weakness of regional economic institutions and was coincided with the shrink in intra-Asia trade which in turn provided incentives for countries in the region to create more stable framework for cooperation such as EU and NAFTA. The trade liberalization process among East Asian countries started in the early 1980s which relied on the unilateral and voluntary basis. Except AFTA, East Asian countries until late 1990s often stayed outside of preferential trade agreements. The new

¹ Paul Krugman, "The Myth of Asia's Miracle", Foreign Affairs, November/December 1994

² Kim Dae Jung, "Is Cultural Destiny", Foreign Affairs, November/December 1994.

wave of trade liberalization in the region was prompted by Japan, a country until recently has consistently followed multilateralism and non-discrimination approach to trade due to its diverse export markets. The White Book on International Trade issued by MITI in 1999 has signaled the change whereas Japan supported a Free Trade Areas in Northeast Asia. With the signing of Japan- Singapore Economic Partnership Agreement in January 2002, Japan's change of direction in its trade policy has been realized. Prime Minister Koizumi in his trip to Southeast Asia in 2002 also put forward the initiative for comprehensive economic partnership between Japan and ASEAN.

After gaining international as well as regional prestige as an economic anchor for Asia during the 1997 crisis, China continued to strengthen its position as a locomotive for economic development in the region. At the ASEAN+3 Summit in Brunei in 2001, Chinese Prime Minister Zhou Yong Ji put forward the proposal to set up a free trade area between China and ASEAN. The proposal received ASEAN support and in November 2002, two sides signed the Framework Agreement to set up such free trade area.

On the ASEAN side ,the ASEAN Free Trade Area has now been virtually realized. The six original signatories have reduced tariffs on all products listed in their 2002 Inclusion List (IL) to 0-5 percent. Since 1 January 2003, tariffs on 99.55 percent (44,160 tariff lines out of total 44,361 tariff lines) of products in the 2003 IL of the ASEAN-6 have been reduced to the 0-5 percent tariff range. The newer members of ASEAN still have to reach the 0-5 percent tariff for intra-ASEAN trade – Viet Nam in 2006, Lao PDR and Myanmar in 2008, and Cambodia in 2010. Overall, in 2003, 87.85 percent of all products in the IL of the ten Member Countries tentatively have tariffs of between 0-5 percent and about 10.68 percent of these products have tariffs of above 5 percent. Ultimately, tariffs

will be completely abolished by 2010 for ASEAN-6 and 2015 for the newer members with flexibility on some sensitive products until 2018.

ASEAN Economic Ministers have also approved Singaporean initiative to set up an ASEAN Economic Community in their last meeting in Cambodia. The Ministers approved the recommendation of the High Level Task Force (HLTF) on Economic Integration to formalize the ASEAN Economic Community (AEC) as the end-goal of ASEAN economic integration as outlined in the ASEAN Vision 2020. As an AEC, ASEAN would be a single market and production base, characterized by the free flow of goods, services, investment and skilled labour, and freer flow of capital by year 2020. The AEC would be realized by strengthening existing initiatives and building new initiatives to enhance economic integration on a progressive basis but with clear timelines. In short, after the 1997 crisis, the discourse of development in Asia has been dominated by free trade instead of the cultural one during the previous years. The benefit of trade notwithstanding, this discourse and policy orientation have not taken the task of setting up and improving the quality of domestic institutions seriously. That's the reason why Asian economic recovery has not been on solid ground so far.

IV. Home as the engine of growth: taking domestic institutions seriously.

It is widely accepted that the purpose of the world trade regime is to raise living standards all around the world rather than just to maximize trade per se. Increasingly, however, the WTO and multilateral lending agencies have come to view these two goals as synonymous to the point that trade has become the lens through which development is perceived rather than the other way around.

In a recent analysis, Dani Rodrik, however argued that “economic growth is rarely sparked by imported blueprints and opening up the economy is hardly critical at the outset. Initial reforms instead tend to combine unconventional institutions innovations with some elements from the orthodox recipe. They are country-specific, based on local knowledge and experimentation. They are targeted to domestic investors and tailored to domestic institutional realities”³.

The literature of economic growth is associated with three prominent schools of thought. First, there is a long tradition of theorizing that places geography at the center of the story. Geography is the key determinant of climate, endowment of natural resources, disease burden, transport cost, and diffusion of knowledge and technology from more advanced areas. It exerts therefore a strong influence on agricultural productivity and the quality of human resources. Recent writings by Jared Diamond and Jeffrey Sachs are among the more notable work in this tradition.

A second school of thought emphasizes the role of international trade as a driver of productivity change. Its main argument is that market integration and impediments thereof play a leading role in fostering economic convergence between rich and poor regions of the world. Notable recent research in this camp included Frankel and Romer and the pregeography work of Sachs.

The third school of thought centers on institutions, and particularly the role of property rights and the rule of law as the main driver of economic growth. In this view, what matters are the rules of the game in a society and their conduciveness to desirable economic behavior. This view is associated most strongly with Douglass North who argued that there is a direct link between institutions, institutional change and economic

³ Dani Rodrik, “The Global Governance of Trade as if Development Really Mattered”, UNDP 2002

performance of different countries⁴. And in a recent working paper, Dani Rodrik has used statistical evidence to support the view that institutions have primacy over geography and integration in economic development⁵. If that is true, then East Asian economies should invest more in institution building. The problem is that with the conditionality of aid donor and the preoccupation with the integrationist agenda, in most developing countries in the region development priorities such as domestic institution buildings have been crowded out. The reason is that at the present, integrating into the world economy is no longer a matter of simply removing trade and investment barriers. Countries have to satisfy a long list of institutional requirement in order to maximize the gain and minimize the risk of participation in the world economy. Global integration remains the prerequisite for economic development but there is now a lot more to it than just opening the border since the rules for admission into the world economy reflect little awareness of development priorities. In this context, a strategy focused on integration crowds out more development friendly alternatives. As rightly argued by Peter Evans “a strategy that focuses on getting the state out of the way of the market overlooks the important functions that the state must play during the process of economic transformation. What belongs on the agenda of institutional reform is building up state capacity – not diminishing it”⁶.

World markets are a source of technology and capital that developing countries must rely on. But successful development strategies have always required a blend of imported practices with domestic institutional innovations. Policy makers therefore need to design

⁴ Institutions, Institutional Change and Economic Performance, Cambridge University Press 1990.

⁵ Dani Rodrik, Institutions Rule: The Primacy of Institutions in Economic Development. Harvard Center for International Development, October 2002.

⁶ Peter, Evans “Economic Governance Institutions in a Global Political Economy: Implication for Developing countries”. UNCTAD, 2000.

domestic growth strategy, relying on domestic investors and domestic institutions. One of the negative impact of the integrationist agenda is to crowd out serious thinking and efforts along such lines.

V. East Asian development models

When East Asian economies were at their peak in the late 1980s, early 1990s, Western critiques labeled them as developmental capitalism meaning a strong and unfair state intervention in the economy. With the 1997 financial crisis, this East Asian model was considered to have passed its eclipse. However, with the recent surge in regionalism and regional economic cooperation, it's useful to formulate a new discourse on East Asian development model based on its past success and failure. Recently, at the Fukuoka Symposium on the Initiative for Development in East Asia organized by the Ministry of Foreign Affairs of Japan and the Japan Institute of International Affairs, several speakers have come forwards with new ideas about East Asia development model. According to Professor Ryokichi Hirono, East Asian economies can be characterized as "Social Market-Economy Approach" as compared to what he terms the Liberal Market Economy Approach most often observed in Western countries. The differences are :

- i) Importance of complementary and balanced relations required between Effective Competition under market forces and Effective Cooperation among all actors at households, corporate, community and national levels and among those institutions.
- ii) Centrality of Human-Centered Development and Growth with Equity, prioritizing investment in human capital for growth and social equity for

income distribution, resulting in higher values for Human Development Indicators such as literacy, enrollment ratios, life span.

- iii) Overwhelming importance attached to pragmatism as against ideology at all levels of decision making in the formulation and implementation of economic, social and governance policy.

In this context, the discourse on development in East Asia is now focus on the ways to make the best use of the region strengths in both cultural and economic term. In other words, East Asian countries are learning from each other and helping each other in a more solid and substantial way as compared to the pre- crisis period. At the same time, it should be noted that domestic institutions building and strengthening is the key for sustainable development. The topic of our section: home as the engine for growth, therefore is very timely and appropriate.