THE BUSINESS TIMES

PUBLISHED DECEMBER 20, 2012

The way forward to Wave 3 growth

The post-World War II 'miracle' Wave 1 growth, shared by many regional economies, was a result of the Cold War

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Need for speed: Although Apec member economies are committed on paper to 'behind the border' reforms, progress has been slow despite the Apec Individual Action Plans (IAPs). To enable Wave 3 growth, the first step is to strengthen intra-Apec accountability for effective implementation of these IAPs. - PHOTO: REUTERS

THE Cold War was a battle for ideological leadership in political and economic domains between two nuclear powers which grew to accept a status quo based on the principle of mutual assured destruction (MAD). Asia and the Pacific region became in reality the front line of the Cold War as a result of three interrelated forces.

First, following the establishment of what wartime British prime minister Winston Churchill called an "Iron Curtain drawn across Europe", the battle for ideological "territory" shifted to Asia, where the post-World War II wave of decolonisation was creating newly independent nations facing tough choices about which political and economic system they would choose and therefore which "bloc" they would join.

Second, the United States, with almost 50 per cent of global output, played to its economic advantage and championed the creation of new global institutions - the World Bank, the International Monetary Fund, and the General Agreement on Tariffs and Trade - to finance development and encourage trade, aid and investment flows for those countries which adopted Western political and economic systems.

Third, the US sought to leverage its advantage in science and technology. This included increasing investment in military technologies, which in turn led to an explosion of dual use - that is, civilian as well as military applications.

The result was faster and cheaper commercial transport, communications and computing. With manufacturing now able to co-locate with low-cost labour - not with consumers - there was an explosion in "smart" foreign direct investment (FDI) - that is, not just capital, but capital plus product and process design technology and linkage into global supply chains.

This "Wave 1" growth was the beginning of a global division of labour - and unprecedented wealth creation - for countries that adopted the then unfashionable, labour-intensive, export-oriented industrialisation growth model.

Which economies were the "early adopters" - and why?

To answer this question, it is important to distinguish the situation - and policies - of a special case, Japan, from the rest of the region. Pre-WWII Japan was already the region's largest and most sophisticated economy. Although Japan's 10 per cent plus growth during the 1960s and early 1970s was referred to as an "economic miracle", Japan's investment in physical, institutional, governance, policy and human capital infrastructure can be traced back to the Meiji Restoration of 1868.

Unlike its underdeveloped Asian neighbours, whose former colonial masters had in the main under-invested in institutional, physical and human capital, Japan was never colonised and in 1945 was on most counts still a developed industrial nation ravaged by war.

Japan's capacity to absorb US post-WWII investment to rapidly rebuild and modernise its infrastructure and industrial base under a US security umbrella plus its culture of strong government-industry collaboration meant Japan was indeed an early beneficiary of globalisation - but from a very different starting situation from its neighbours.

Outside Japan, the four, resource-poor, newly liberated and newly industrialised economies (NIEs) - Hong Kong, Korea, Singapore and Taiwan - became the first of the developing regional economies to demonstrate the potential of this new development model .

Why these four? Simply put, they had no other choice. Each experimented unsuccessfully with protectionist and import-substituting orthodoxy and, in the absence of natural resources, they opened up to foreign capital and skills out of desperation - they had nothing to lose.

Given the success of this new, labour-intensive, export-oriented growth model to raise underdeveloped nations out of poverty, why was it not adopted elsewhere in the world? Or in the Asian region?

To the first question, I would argue this is a result of the - complex - interaction between the people, culture, geography and history. The Chinese and Korean peoples who make up the bulk of these four economies have deep cultures dating back several thousand years, commercial and trading skills honed by access to seasonal monsoons which created the ancient "Maritime Silk Road", plus a more recent colonial history where rule was often through an elite educated in the capitals of Europe whose world view was changed by their experience during Japanese occupation.

To the second question, I would argue that there are two key factors.

- **Political systems:** Countries with geographic, cultural or historical links to the Soviet Union and the People's Republic of China (PRC) adopted communist or socialist political models that were accompanied by some variant of centrally planned economies. This held back their ability to share in the benefits of global trade - which in the "miracle" years was growing at three times the rate of global GDP growth.
- **Resource endowment:** Under a perceived threat of communist external aggression and internal subversion, the resource-rich economies in Asean mostly adopted Western political and market models - but retained the then prevailing economic orthodoxy of import substitution. Foreign investment and ownership was tightly controlled, as was the employment of foreigners.

The Second Wave

The end of the first wave of growth was the result of a combination of global economic weakness that followed the oil price shock of 1979 and the internal challenge faced by all four NIEs in restructuring their economies to break out of the middle-income trap. By the mid-1980s, growth in the NIEs was slowing and in 1985 Singapore suffered the worst recession in its history with GDP recording a rate of -1.5 per cent.

This might have been the end of the "miracle" but for the emergence of three new, exogenous growth drivers:

- **The PRC opening up:** The Four Modernisations announced in 1978 by then paramount leader of the PRC, Deng Xiaoping, was in reality admission that the concept of centrally planned economies had failed. Over the ensuing decade, this led to not just the PRC, but other communist economies joining the global supply chain.
- **Plaza Accord:** By the mid-1980s, the US "triple deficit" was causing global imbalances and at a G5 meeting in New York in 1985, the Plaza Accord led to a rapid appreciation of the yen versus the US dollar. This caused a dramatic outflow of labour-intensive industry into low-labour-cost, hitherto import-substituting, economies across South-east Asia - with some countries receiving more FDI in 18 months than in the preceding 18 years.
- **Pan and sub-regional integration, eg, Apec and AEC:** The creation of Apec in 1989 has contributed positively to a healthy integration of regional and global supply chains and to dramatic declines in regional tariffs. Of the world's US$14.3 trillion in trade in 2010, 67 per cent, or US$9.6 trillion, involved Apec economies (Pacific Economic Cooperation Council 2012, or PECC).

The Third Wave?

While global, then-regional economic integrations were crucial to post-WWII growth - the implicit assumption that the exogenous forces embedded in the two earlier development models will continue to apply may be fundamentally flawed.

Following the end of the Cold War and the global financial crisis, the European Union (EU) and the US face a protracted period of slower growth, rising unemployment - and pressure on outbound FDI and on investment in dual-use technologies -

that is, those with commercial as well as defence applications. There is also the danger that economic crisis, collapsing currencies and rising unemployment in parts of the EU may lead to the emergence of populist or extremist governments - witness the recent gains of the right in Greece. History suggests this may presage a possible return to some form of "disguised" protectionism that will further undermine the earlier growth models.

Many countries in the region are unprepared. They have taken advantage of the "low hanging fruit" of rapid growth during Waves 1 and 2. The politically challenging domestic, "behind the border" reforms required to boost economic competitiveness and prepare for Wave 3 growth have not been addressed.

These economies typically score poorly in, for example, World Bank Doing Business and Transparency International perceptions of corruption rankings. With rising competition for a reduced flow of FDI and tougher "compliance" legislation in many OECD (Organisation for Economic Co-operation and Development) economies these nations will be disadvantaged.

In parallel to tackling the politically challenging domestic reforms, leaders can sustain growth by accelerating infrastructure investment, ideally with private-sector involvement via public-private partnerships (PPPs). This will in turn increase domestic and international competitiveness. Effective PPPs will help to convert infrastructure from bottlenecks that choke growth into catalysts of Wave 3 growth.

The numbers are large. The Asian Development Bank (ADB) and Asian Development Bank Institute (ADBI) publication Infrastructure for a Seamless Asia estimated that US$8.3 trillion needs to be invested in new national infrastructure across the region in the decade ahead (ADB and ADBI 2007).

An Economist Intelligence Unit report commissioned by ADB, 2011 Infrascope Report, estimated that a significant percentage of this investment would be in the growth-enabling areas of energy and transportation and funded through PPPs.

However, the providers of the expertise and "patient" capital required for successful PPPs need not only transparency of investment - and legal - rules (for example, land title and dispute resolution) today - but policy certainty and predictability for the multi-decade life of a project. This includes confidence in the political will of present and future leadership.

For example, when a contractual increase in road tolls or water tariffs falls due, confidence that the government of the day will not back down under pressure of short-term political expediency will be critically important.

Wave 3 growth requires political, policy and institutional reform:

The exogenous forces of first the Cold War and globalisation, then the PRC's opening and the subsequent regional integration created a "surf wave" that enabled rapid growth during Waves 1 and 2. The weakening of this "surf wave" is apparent and, to sustain growth, governments in the region need to accelerate difficult domestic reforms to ignite a new, Wave 3, growth model.

Although Apec member economies are committed on paper to "behind the border" reforms, progress has been slow despite the Apec Individual Action Plans (IAPs). To enable Wave 3 growth, the first step is to strengthen intra-Apec accountability for effective implementation of these IAP's.

In parallel, Apec members and their partners must enhance skill transfer in policy development and execution from developed to developing members. Institutions such as ADB and ADBI, Unescap (United Nations Economic and Social Commission for Asia), OECD, PECC, and the aid agencies of developed nations have an important role to play. However, the central, starring role in leading the transformation to Wave 3 growth must be taken by national political leaders in the region.

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