

SOME EAST ASIAN LESSONS FOR AFRICAN DEVELOPMENT?

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Abstract

This paper critically reviews the World Bank's treatment analysis of the East Asian miracle. The Bank considers the Northeast Asian experience so extraordinary that other developing countries cannot emulate Japan, South Korea and Taiwan. Instead, the Bank claims that Southeast Asia achieved its miracle by liberalizing its economies from the mid-1980s. Instead, this paper argues that the Bank's portrayal of Southeast Asia is misleading, that Southeast Asia's achievement is considerably more modest than Northeast Asia's and that economic liberalization has often undermined the state capacities and capabilities necessary for developmental states.

The paper then goes on to critically review the evidence on the adverse consequences of economic liberalization in Sub-Saharan Africa, very often due to conditionalities associated with structural adjustment programs of the World Bank and other international financial institutions. It argues that it will be crucial to enhance state capacities and capabilities for Sub-Saharan Africa to achieve more rapid economic growth and development.

1. INTRODUCTION

Over the past two decades, Sub-Saharan African (SSA) income growth has barely kept pace with population growth. After attaining a moderate increase in per capita income during the 1970s, SSA growth averaged 2.1 per cent per annum in the 1980s and 2.4 per cent in the 1990s. Despite a short-lived recovery after the mid-1990s, SSA per capita income at the turn of the century was 10 per cent below the level reached two decades earlier. Slow and erratic SSA growth has been accompanied by regressive income distribution trends. The drop in average per capita income for the

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poorest 20 per cent in SSA was twice that for the entire population between 1980 and 1995 (UNCTAD 2001a: 53).

For SSA, the new generation of policies espoused by the "Washington Consensus" – now involving "getting prices right", "getting institutions right" and "good governance" – are still offered as advice, if not imposed as conditionalities. Income levels in most of SSA are too low to generate the domestic resources needed for rapid growth. Meanwhile, under the Heavily Indebted Poor Countries (HIPC) initiative, only part of total debt is eligible for relief and even then, only for some indebted countries. Furthermore, despite some recent acceleration in implementation, HIPC progress remains slow. In mid-2002, some six years after the launch of the HIPC initiative, only Burkina Faso, Mozambique, Uganda and Tanzania from the 33 African countries included in the HIPC list of 42, had reached completion.

According to the World Bank, by 1998, a quarter of the population of the developing world, i.e. 1.2 billion people, were living below the poverty line, namely below US\$1 per day in 1993 purchasing power parity terms. Excluding China, where the number of poor has gone down with rapid economic growth, the number of poor people increased from 880 million in 1987 to 986 million in 1998. The number of poor in sub-Saharan Africa (SSA) rose from 217 million in 1987 to 291 million in 1998, averaging around 46 per cent of the SSA population over the period (World Bank 2001:17 & 23). The proportion of the population on less than US\$1 a day in the least developed African countries has increased since the late sixties, rising from an average of 55.8 per cent in 1965-69 to 64.9 per cent in 1995-99 (UNCTAD 2002: Tables 19 & 20).

Over the last two decades, real wages have fallen as adjustment policies have hollowed out the nascent middle class in SSA. It is very difficult to reduce poverty through redistribution when the average income levels are very low as in SSA. Hence, sustained poverty reduction can only proceed on the basis of rapid and sustained growth and job creation. However, the link between BWI adjustment and economic growth is weak, if at all positive: of the 15 countries identified as core adjusters by the World Bank in 1993, only three were subsequently classified by the IMF as strong economic performers. And rapid growth among most strong performers can be explained by special circumstances unrelated to structural adjustment policies.

Until the Japanese stagnation from the 1990s and the 1997-98 East Asian currency and financial crises, nine East Asian economies experienced rapid growth and structural transformation over several decades. Since then, China and South Korea have continued to grow and industrialize at a rapid pace. Although apparently now over, the East Asian miracle contrasted sharply with the experiences of most of the rest of the developing world, especially in the last two decades. Hence, this paper seeks to draw some lessons from these experiences which seem crucial for developmental policy-making and implementation.

2. LESSONS FROM EAST ASIA?

It is useful to begin by reflecting on two volumes—the Asian Development Bank's (ADB) mid-1997 publication, *Emerging Asia: Changes and Challenges* (EA), and the World Bank's (WB) earlier (1993) *East Asian Economic Miracle* (EAM), particularly on the role of government in East and Southeast Asian development. The ADB's EA study is likely to have considerable influence, perhaps because it is more reader-friendly than the EAM volume published by the WB. Another reason is that it is more conformist, with few exceptions, uncritically endorsing the neo-liberal ideology and policy agenda of our times.

However, unlike most other studies of Asia, the ADB volume seriously considers geography, demography, the environment, natural resources, and quality of life issues, albeit in ways many of us may take issue with, but nonetheless usefully, though mainly predictably. This is no trivial matter. For example, the WB's EAM study acknowledges that the likelihood of eight relatively contiguous economies all achieving relatively rapid and sustained growth for over a quarter of a century is very, very remote, but did not see fit to come to terms with this. While economics obviously has difficulties in dealing with geography, it is unfortunate that neither study has sought to address Akamatsu's original 'flying geese' hypothesis, or subsequent variations thereof, even if only to reject them.

No Flying Geese?

While the EA study seems to have gone beyond the EAM study in recognizing the significance of geography, the study does not seriously consider the 'flying geese' and other related propositions. Proximity seems to matter, as suggested by the recent domino effect in the collapse of Southeast Asian currencies, but there is no attempt to seriously consider other implications of geography for economic development, whether in terms of agglomeration, regional integration, currency zones, etc.

Similarly, the significance of exchange rate competitiveness is not seriously considered, either for East Asia or Southeast Asia. The post-1986 boom in the second-tier Southeast Asian NICs came after their currencies depreciated against the US dollar, and even more against the yen, won, New Taiwan dollar and Singapore dollar, effectively lowering production costs in these economies and thus increasing their attractiveness as production locations.

Tropical Fate?

The EA study claims (p. 77) that temperate countries grew, on average, by 1.3 percentage points more than tropical countries during the 1965-90 period, after controlling for other factors. The study explains this significant shortfall in terms of the

greater prevalence of disease, poorer soils, more frequent typhoons and other natural calamities in the tropics.

Surprisingly, the EA study seems to be oblivious to W. A. Lewis' (1969; 1978) pioneering work on the economic condition of the tropics. As Lewis (1978) has shown, tropical exports grew faster than temperate zone exports during the last period of global liberalization from the end of the last century. For the period 1883-1913, for example, French Indochina, Thailand, British Ceylon, West Africa, French West Africa and Madagascar all had average annual export growth rates of five per cent or more, while Brazil had 4.5 per cent. The comparable rates for temperate settlements, the USA and Northwest Europe were 4.3, 3.8 and 3.5 per cent respectively.

While the tropics generally had more modest export bases than the temperate zone, this also suggests that the tropics were able to respond to export demand despite the disadvantages they faced. Lewis emphasized that not all tropical countries were able to seize the opportunities from increased export demand. He suggests that the exports in greater demand were largely water-intensive; hence, only those areas with enough water to substantially increase their exports were able to take advantage of the new opportunities. The more arid tropical grassland areas thus could not benefit from the increased demand for tropical products.

Since the Southeast Asian newly industrializing countries and some other tropical countries have also grown rapidly since the sixties, it is necessary to explain why countries in the tropics have fared so badly in the last few decades. It is not enough to simply attribute the tropical growth shortfall simply to 'pests, diseases, typhoons and other natural calamities' though such factors may not have been unimportant.

In a variation of the Prebisch-Singer argument about the declining terms of trade faced by the countries in the periphery, Lewis has observed that the terms of trade for tropical exports deteriorated badly against temperate exports. In the half century between 1916 and 1966, for example, the index for natural rubber fell from 100 to 16. This suggests that productivity gains in the tropics were largely lost to the worsening terms of trade, and the situation would have been even worse where few productivity gains were made. Such phenomena compel us to reconsider the challenge to conventional international trade theories posed by proponents of 'unequal exchange'.

Intal (1997) has suggested that sub-Saharan Africa has lagged behind in terms of agricultural development since the sixties due to inadequacies in agricultural R&D and infrastructure, crop and agronomic considerations and macroeconomic conditions. He argues that higher temperate agricultural productivity has partly been due to long, sustained and larger investments in agricultural R&D, which temperate LDCs (e.g. Chile, Korea and Taiwan) have been better able to take advantage of. The tropical Green Revolution in rice farming since the sixties has mainly benefited irrigated farms

in Southeast and South Asia, while drier agricultural practices in Africa have generally been left out.

However, the Malaysian, Indonesian and Thai success with tree crop agriculture offers some hope. The Malaysian experience, in particular, suggests that significant investments in tree crop agricultural R&D (e.g. in rubber, oil palm and cocoa) as well as rural infrastructure have made possible productivity gains in tree crop agriculture as well. The geographic specificities of agriculture imply that for imported agricultural varieties and technologies to be successfully adopted, there is a great need for effective adaptive investments in R&D and extension. Unfortunately, in their desire to industrialize, some governments have neglected agriculture, or worse still, subjected it to considerable policy bias.

Resource Curse?

The EA study also suggests that being a natural resource rich country is bad for growth. Curiously, the study defines natural resource abundance in terms of the ratio of net primary product exports to GDP in 1971 without distinguishing between extractive natural resources (especially minerals) from agricultural products. So-called Dutch Disease mainly involves the former, which tend to be very capital-intensive and only involve a small proportion of the population in the extraction of the resource. Consequently, the added income accrues to a few while the appreciation of the country's currency affects the entire population.

Agricultural exports generally involve much more of the population, and increased income usually accrues to all producers, diffusing the adverse consequences of currency appreciation. The Southeast Asian high performing economies have been major agricultural exporters, thus offsetting the problems associated with the mineral exports of Malaysia and Indonesia, in sharp contrast to, say, Nigeria. Generally good macroeconomic management has also helped, especially to offset the tendency to indulge in expenditure on non-tradables.

Wage Competitiveness?

Citing Lindauer and Valenchik (1994: 288-9), Intal (1997) has argued that the marginal labour productivity and hence the opportunity cost of farm labour for manufacturing is higher in land-abundant African economies compared to land-scarce Asian economies even though average labour productivity is usually higher in the latter. Hence, it is unlikely that the former will be able to compete with the latter in labour-intensive manufactures. The Malaysian experience suggests that such labour-scarce, land-abundant economies can only be competitive in skill-intensive, rather than unskilled labour-intensive manufactures, requiring considerable investments in human resource development.

Comparing wage rates to labour productivity in manufacturing for 1992, Intal (1997: Table 4) shows the high proportion of wages and salaries to value addition per worker in economies such as Hongkong (0.51), India (0.39) and Singapore (0.34) compared to Malaysia (0.28), South Korea (0.26), Philippines (0.23), Sri Lanka (0.19), Thailand (0.15 in 1990) and Indonesia (0.14). This suggests that the low wages received by Indian workers do not automatically translate into labour cost competitiveness. The situation in much of Africa suggests that not unlike Indian labour, African labour may also not be competitive in wage/productivity terms.

Role of Government

Let us now consider the role of government in Asian, especially East and Southeast Asian growth. At the risk of caricature, it seems fair to suggest that there have been three, sometimes distinct, sometimes overlapping explanations of the role of the state in what the World Bank (1993) has called the East Asian economic miracle. These may be described as follows:

- 1) minimal state
- 2) market-friendly state
- 3) developmental state

The first, essentially *laissez faire* approach arguing for a minimal role for the state basically asserts that the state has been largely irrelevant or, even worse, actually obstructive of the essentially market forces which have contributed to rapid growth and structural transformation, including industrialization. The original and most articulate exponents of this view include Little, Scitovsky and Scott (1970), but there are many supporters of this view. Interestingly, these include the many liberals and neo-liberals who have opposed the Park Jung Hi and subsequent military regimes in South Korea and Taiwanese 'islanders' who resent any suggestion that the mainlander Guomindang (KMT) regime may have contributed to development on that island. Such a view became especially influential in the early eighties as the ideological pendulum in the Anglophone world swung to the far right after the election of Mrs. Thatcher and Mr. Reagan. This view was consistent with what John Toyne (1987) has called the 'counter-revolution' against development economics led by Peter Bauer and Deepak Lal, reflected for example in the World Bank's World Development Reports of the early and mid-eighties.

The second, currently popular case for the market-friendly state was greatly enhanced by the World Bank's (1993) East Asian Miracle (EAM) study, and is likely to be seen as drawing additional support from the ADB study we are now considering. Drawing from neoclassical welfare economics, this view accepts the case for government intervention due to the existence and greater significance of externalities and market failures. This approach has given new life to and justification for development economics - which had come under near fatal assault in the early eighties, as noted

earlier - by emphasizing the more pervasive and deep-rooted nature of externalities and market failures of various types in developing economies. The persistence of such externalities and market failures made the case for what the World Bank (1993) refers to as 'functional' interventions—as opposed to 'market—unfriendly' 'strategic' interventions, which the World Bank did not approve of.

While largely accepting the arguments for state interventions to address market failures, the advocates of the developmental state perspective emphasize that the nature of government interventions in East Asia generally went well beyond the market-friendly functional interventions approved of by the World Bank. While the World Bank disapproved of so-called strategic interventions, the proponents of the developmental state perspective insist that selective industrial policies - involving trade, financial and other interventions - have accounted for 'late industrialization' in East Asia (Amsden 1989; Chang 1994; Wade 1990). The key argument is that such interventions have been crucial for developing new industrial capabilities which did not previously exist and which would not have spontaneously emerged due to market forces alone. Thus, the old 'infant industry' argument was resuscitated, with insights from Gershenkeron's (1962) observations on the advantages of economic 'backwardness' as well as the requirements of 'late industrialization'. The developmental state advocates emphasized the role of 'strong states' (in Myrdal's sense) as well as the manipulation, if not distortion of market mechanisms to achieve developmental objectives.

There is, of course, considerable variation in perspectives within the three camps, as well as positions that may be seen as intermediate. For example, a significant number of institutionalists have identified and emphasized collective action problems and coordination failures, which may be best addressed by direct government intervention or, alternatively, by private sector collective initiatives, or by improved government-private sector consultation, or even by corporatist institutions and mechanisms. In so far as some such problems may not be generally acknowledged as market failures, the related solutions may not be seen as within the pale of acceptable market-friendly interventions. And in so far as the intervention may be anticipatory or pro-active, rather than reactive, it is more likely to be seen as strategic rather than functional.

As noted earlier, the WB's EAM study approves of market-friendly functionalist interventions—such as ensuring good governance, sound macroeconomic management, physical and social infrastructure provision and high savings and investment rates - while eschewing market-distorting strategic interventions. Nevertheless, given the significance of the latter, particularly in Northeast Asia, the EAM study considered the impact of the latter, particularly 'directed credit' and 'industrial policy-related trade interventions. The EAM study insisted that the latter failed in East Asia, while conceding that 'directed credit' worked. However, the WB suggested that the conditions and circumstances of such limited success in Northeast Asia were very unusual, if not unique (Confucianism, bureaucratic capability, favourable initial and international

conditions, etc.), and therefore not to be emulated.

Demystifying Krugman

Growth accounting exercises—suggesting little total factor productivity (TFP) growth in most of the region—have also been invoked by the WB, Paul Krugman (1994) and others to suggest the inferiority of East Asian growth in achieving technical progress. The main conclusion drawn is that rapid growth in the region has largely been due to massive factor (capital and labour) inputs due to high savings and investment rates, foreign direct investment, growth of the wage labour force in the formal sector and human capital investments. Further factor inputs are bound to run up against diminishing returns, and rapid East Asian growth cannot be sustained, at least at the breakneck pace of the last three decades.

There is no time here to go into an extended discussion of the theoretical as well as methodological issues involved. However, Dani Rodrik's observation (in Collins and Bosworth 1996: 120) that 'the evidence on investment rates is direct and speaks for itself, the evidence on TFP is indirect and has to be interpreted with care'. Also, Collins and Bosworth's (1996) more recent findings suggest that East Asian economies have been evolving toward greater TFP gains since the eighties as they attain a higher stage of development. They also argue that future growth in the region can be sustained as the educational and skill profiles of the labour forces continue to grow.

Many East Asians have been deeply offended by Krugman's comparison of East Asian growth with that of the Soviet Union in earlier times, and the implications that East Asian economic performance has not been all that miraculous and that slower growth is unavoidable and imminent. However, there has been less critical attention to the basis of his analysis, namely the more conventional neoclassical growth accounting exercises by Alwyn Young (1994) on the one hand, and the more heterodox exercise by Kim Jong-Il and Lawrence Lau (1995).

Krugman is probably right in claiming that the new endogenous growth theory cannot be invoked against his arguments as even higher TFP residuals would then be expected. However, if technological learning only becomes important beyond a certain stage of development or when technological progress requires changes in the labour process more conducive to such learning and shop-floor innovation, one would have different expectations of TFP growth in East Asia outside of Japan.

But even if we accept the theoretical and methodological bases for Krugman's claims (which are not unproblematic), there is good reason to suspect his conclusion of lack of technological progress when one considers the consequences of differences in price determination in different product markets which affect growth accounting exercises. In this case, the important distinction is between the more technologically

sophisticated products, enjoying legally protected monopolistic rents, and other more mass-produced products in far more competitive markets. The differences in the nature of the labour markets have also had some bearing on product price determination. Most East Asian workers outside of Japan have been under-remunerated owing to international labour immobility, among other factors, resulting in the relative under-valuation of the prices of East Asian exports in international trade.

Regional Differences

The different economic performances of the three regions considered by the EA study do not merely involve differences in economic growth, or even of structural transformation, though these are not unimportant. Before the nineties, the World Bank's first-tier East Asian HPAEs (including Singapore) grew by almost two percentage points more than the three second-tier Southeast Asian NICs (Malaysia, Thailand and Indonesia); the difference was even greater on a per capita basis owing to the higher population growth rates in the latter. When one considers the far larger contribution of natural resource rents to the latter's growth performance, the former's achievement is even greater.

Whereas the EAM study obscured this difference, the EA study addresses it in terms of regional differences. Unfortunately, neither study pays sufficient attention to the major policy differences between the two regions and their consequences in terms of 'late industrialization'. Industrial policy has been far more extensively deployed in Japan, South Korea and Taiwan than in the second-tier Southeast Asian NICs. The success of such industrial policy is reflected in the greater industrial and technological capabilities of the former compared to the latter.

Neither study comes to terms with the fact that the former selectively kept out foreign investment, with FDI only accounting for a modest share of gross domestic capital formation. In contrast, FDI has been far more important in Southeast Asia, especially in Singapore and Malaysia, and that too partly for political reasons. In Singapore, the government was initially concerned with quickly developing a strong foreign stake in the future survival of Singapore after it seceded from Malaysia in 1965. The ruling People's Action Party (PAP) also remained sceptical of domestic business interests, who had supported other political parties before the PAP came to power. In Malaysia, the ethnic Malay-dominated government seems to have favoured foreign investment as an alternative to ethnic Chinese domination of the national economy while the ethnic Malays expand their stake.

In making regional generalizations, the EA study glosses over many important differences within the three main regions considered. In reviewing the EAM study, Dwight Perkins (1994) suggested that generalizations about East Asia obscured the existence of at least three distinct East Asian types among the eight HPAEs - the Northeast Asian HPAEs (including Taiwan), the Southeast Asian HPAEs and the two

city states of Hong Kong and Singapore. The significance of industrial and technology policies as well as state-owned enterprises in the island republic, in contrast to the recently returned British colony, underscores the difficulties in making facile generalizations. Any alternative categorization would also be moot, but the recognition of such variety is often obscured in stressing regional similarities. State-owned enterprises have performed well in Singapore and perhaps in Taiwan as well, but less well in Malaysia and Indonesia, which is not surprising given the circumstances of their establishment and management.

The Joys of Openness?

The ADB's EA study argues that *market competition, openness, and export orientation* were the key ingredients of East Asia's miraculous economic performance. It is not possible to address these claims comprehensively here, but fortunately for me, others have already done so very persuasively.

On the claim of market competition, one can refer to the World Bank's discussion of the importance of 'contests' in East Asia. In line with the Austrian School critique of the neoclassical economic fetish for perfect competition, East Asian governments have not been insistent on competition to avoid wasteful, excessive competition and to enable firms to achieve economies of scale. Contests or managed competition as well as managed exposure to international markets have instead been used to force firms to become internationally competitive as quickly and as reasonably as possible.

Both studies also repeat the neo-liberal mantra of trade liberalization and economic openness without fully acknowledging the critical difference between 'free trade' a la Little *et alia* and the juxtaposition of export subsidies against import protection, as in Northeast Asia. As many have noted, the East Asian governments have not been as open to free trade as claimed by the EA study. Instead, Bhagwati (1988) and others have argued that free trade has been 'simulated', with the distortive consequences of import protection in East Asia offset by export subsidies, but this is certainly not free trade as normally understood. Nor were East Asian governments open to FDI as suggested by the Emerging Asia study. As noted earlier, FDI in Japan, South Korea, and even Taiwan has accounted for a smaller proportion of gross domestic capital formation (GDCF) than is the norm for developing countries. Even in the Southeast Asian HPAEs, all with higher than average FDI/GDCF, there has been significant regulation of FDI.

The EA study claims that open economies consistently grew by an average of two percentage points more than considerably closed economies during 1965-90. This finding is dependent on the definitions and categorization of countries as open or closed as done by Sachs and Warner (1995). They assert that Thailand has been consistently open, that Indonesia has been open since 1970 while the Philippines has only been open from 1988. Comparing these three countries, Intal (1997: Tables 1-3)

shows that such an interpretation would require a rather peculiar, if not arbitrary reading of the evidence and classification of the countries. Citing Naya (1989: Tables 2.8-2.9), he shows:

- average import duties in the Philippines in 1982 were slightly lower than for Indonesia in 1980 and Thailand in 1983;
- for intermediate and capital goods, the average import duties for the Philippines in 1982 were lower than for Thailand in 1983.
- quantitative import restrictions and other non-tariff barriers in the Philippines in 1983 were lower than in Indonesia in 1980 for crude materials, chemicals, basic manufactures and transport machinery.

Citing trade-weighted trade control measures from UNCTAD (1987: Supplement) for the mid-1980s, Intal shows that the total tariff and para-tariff measures were higher in Thailand than in the Philippines for 'all manufactures' as well as both chemicals and machinery & equipment. Meanwhile, all non-tariff measures were greater in Indonesia than in the Philippines for both 'all manufactures' and chemicals, and only slightly less for machinery & equipment. Then, citing Ariff and Hill (1985: Tables 3.3, 3.5, 3.7), who only offer comparable figures for Indonesia and the Philippines, he shows that the effective rates of protection for intermediate goods in Indonesia in 1975 and 1980 were much higher than for the Philippines in both 1974 and 1980; the data suggest that the converse was true for capital goods.

The point is clear. The usual indices of trade openness do not allow Sachs and Warner to categorize the Philippines very differently from Indonesia and Thailand. Claiming that the former was closed and the latter two were open would most certainly distort and affect findings about the alleged relationship between trade openness and economic growth since the latter two have performed so much better than the former in the last three decades. Intal comes close to suggesting that their adverse view of government's role in agricultural development - as reflected by their emphasis on 'state monopoly of major exports' as a measure of the 'closedness' of an economy—affected Sachs and Warner's categorization and related claims.

The EA study also ignores the problems of liberalization and openness, such as the causes and consequences of the recent financial crisis in Southeast Asia. Recent experience contradicts the claim that 'the market' will exact swift and painful punishment on governments and economies that do not have their macroeconomic house in order. Rather, the timing, nature and consequences of the mid-1997 financial crisis in Southeast Asia underline the imperfect nature of financial markets. For example, this was reflected in the long delay before 'rectification' of years-old Southeast Asian current account deficits - as acknowledged by International Monetary Fund (IMF) deputy head, Stanley Fischer, in an exchange with US Federal Reserve chairman, Alan Greenspan (*New Straits Times*, 2 Sept. 1997). In a world economy where foreign exchange spot transactions are worth more than seventy times total

international trade transactions, the financial sector has become increasingly divorced from the real economy. With the recent proliferation of new financial instruments and markets, the financial sector has an even greater potential to inflict damage on the real economy.

Even Georg Soros has argued that the unregulated expansion of capitalism, especially finance capital, threatens to undermine the system's viability and future, i.e. that capitalism has to be saved from itself. While admitting that he himself has profited greatly from financial liberalization, he argues that excessive liberalization has resulted in virtual anarchy, which is dangerous for the stability so necessary for the orderly capitalist growth and democratic development desired by his liberal vision of a Popperian 'open society':

Ever since Lord Keynes advocated 'throwing sand' into the financial system to check the potentially disastrous consequences of unfettered liberalization, Keynesians – and others - have been wary of the financial liberalization advocated by ideological neo-liberals and their often naïve allies. Nobel laureate in economics James Tobin has called for a tax on foreign exchange spot transactions to enable more independent national monetary policy, discourage speculative capital movements, and increase the relative weight of long-term economic fundamentals against more short-termist and speculative considerations, besides more than adequately funding the United Nations system and programmes. As many have pointed out, the international financial system and its further liberalization have favoured those already dominant and privileged in the world economy, largely at the expense of the real economy and development in the South.

Dani Rodrik (1994) has challenged the World Bank's EAM study's claim of the significance of export orientation. The economic histories of Japan, South Korea, and Taiwan suggest that most industries began by producing for the domestic market as has been typical of import-substituting industrialization. The East Asian difference has been in effectively requiring and facilitating the rapid transition to production for export, often through the creative deployment of trade policy, as suggested earlier.

All this is not to imply that industrial policy has always been well motivated and successfully deployed. The World Bank's claim of trade policy failure is methodologically problematic, and does not even bother to distinguish government interventions motivated by different considerations, e.g., the desire to enrich a politically influential, or otherwise favoured concessionaire. The EA study cites problems with the Korean heavy and chemical industrialization drive, but just as with the policy failures attributed to the Japanese Ministry of International Trade and Industry (MITI), such selective evidence is not conclusive proof of the failure of industrial policy.

The EA study is quite correct in emphasizing the new constraints in the articulation, elaboration, and implementation of industrial policy, especially those imposed by the new international economic governance, particularly through the World Trade Organization (WTO). But instead of urging Asian governments to work together in their common interest to resist the emerging international economic governance, the EA study seems to urge precisely the opposite, i.e. acceptance and conformity.

Unfortunately, neither the EAM nor the EA studies go very far in trying to explain or understand why government interventions have, on balance, accelerated structural transformation and resulted in the development of significant industrial and technological capabilities in East Asia, and to a lesser extent, in Southeast Asia. This suggests that better understanding of the political economy of government intervention can take us some way towards greater appreciation of some reasons for the different outcomes of government intervention in the three main Asian regions considered by the EA study.

3. ECONOMIC LIBERALIZATION AND DEVELOPMENT IN AFRICA¹

As suggested earlier, the African policy landscape has changed radically over the last two decades. Liberalization and privatisation have replaced state controls and enterprises associated with import substitution. These failures can be traced to the displacement of strategic developmental thinking by an obsession with economic liberalization. Ironically, as Mkandawire (2002) points out, while economic analysis during the pre-liberalization developmental era seriously considered the impact of external factors on economic growth, the subsequent era, often associated with globalisation, has tended to focus on 'domestic' determinants of economic performance. (More recently, this internal focus has gone beyond economic policies to include governance, rent-seeking, ethnic diversity, geography, etc.)

In 1981, the World Bank published its influential *Accelerated Development in Sub-Saharan Africa: An Agenda for Action*, often referred to as the Berg Report, after its principal author. The document is seen as having set out the framework for subsequent economic reform led by the two Bretton Woods institutions (BWIs) over the last two decades in sub-Saharan Africa. The international debt crises from the early 1980s enabled the BWIs to impose the reform agenda as conditionalities for providing desperately needed credit in the face of the Volcker-induced world recession following the deflationary impact of raised US interest rates in the early 1980s.

¹ This part has been heavily drawn from Mkandawire (2002).

While the International Monetary Fund (IMF) was generally responsible for short-term stabilization programmes, the World Bank generally handled medium-term structural adjustment programmes (SAPs). These programmes were later dubbed as part of the Washington Consensus, reflecting the economic policy preferences of the US leadership, particularly its Treasury Department. The Washington Consensus is generally associated with the global trend towards greater economic liberalization since the 1980s, and has changed over time, largely in response to poorer economic performance throughout the world, especially in the developing countries, over the last two decades. Despite Nobel laureate Joseph Stiglitz's suggestion that the Washington Consensus has clearly failed and needs to be replaced by a reflationary and developmental post-Washington Consensus, there is little evidence of significant policy change despite growing dissent over existing policies.

This is clearly reflected by other remarks from the BWIs (e.g. see *Finance & Development*, September 2002), especially with every hint of possible economic success. They and their supporters have continued to deny the possibility that the poor economic performance of the African region, and the world, can be directly attributed to their policies and the underlying ideology pursued over the last two decades. As the IMF put it, "globalisation is proceeding apace and SSA must decide whether to open up and compete, or lag behind" (Fischer *et al.* 1998: 5). Or, as a World Bank economist has argued, "If Africa is to reverse its unfavourable export trends, it must quickly adopt trade and structural adjustment policies that enhance its international competitiveness and allow African exporters to capitalize on opportunities in foreign markets" (Yeats 1997:24). The key message of the Bretton Woods institutions has been to "get prices right" through economic liberalization and privatisation. Commenting on the continuing stagnation of African per capita incomes, *The Economist* (2001:12) argued that "it would be odd to blame globalisation for holding Africa back. Africa has been left out of the global economy, partly because its governments used to prefer it that way".

Most African governments accepted the BWI policies, expecting the promised "catalytic effect" on foreign capital inflows of the BWIs' stamps of approval. After all, rates of return to FDI have generally been much higher in Africa than in any other region (Bhattacharya *et al.* 1997; UNCTAD 1995). This, however, has not made Africa popular among investors, largely blamed on ill-specified and intangible "risk factors". The actual response of private capital has, in the words of the World Bank, "been disappointing" (quoted by Mkandawire 2002). Africa is systematically rated as more risky than warranted by economic indicators. Increased foreign investment into Africa has not increased Africa's share of global FDI flows. Although average annual inflows have increased fivefold, by 1998, the share of FDI going to Sub-Saharan Africa (SSA) (1.2 per cent in 1999) was less than half its share in the mid-1980s (UNCTAD 2000).

However, from the mid-1990s, the BWIs began to claim success for their economic liberalization and adjustment programmes. IMF officials suggested a "turning point"

(Fischer *et al.* 1998), claiming that the positive per capita growth rates of 1995-97 (averaging 4.1 per cent) "reflected better policies in many African countries rather than favourable exogenous developments" (Hernández-Catá 2000, quoted by Mkandawire 2002). Michel Camdessus, then IMF Managing Director, said at the 1996 annual meeting of the World Bank and the IMF, "Africa, for which so many seem to have lost hope, appears to be stirring and on the move". The World Bank President reported to his Board of Governors that there had been progress in the SSA, "with new leadership and better economic policies" (Wolfensohn 1997). A senior IMF official, Alassane Quattara (1997) claimed: "A key underlying contribution has come from progress made in macroeconomic stabilization and the introduction of sweeping structural reforms", while a major World Bank (2000: 21) report on Africa claimed there had been a turn around because of "ongoing structural adjustment throughout the region which has opened markets and has a major impact on productivity, exports, and investment".

The rise in FDI in the late 1990s was cited as evidence that the tide was turning (Pigato 2000).² However, much of the investment in SSA went to South Africa and to mining, which is hardly influenced by macro-economic policy considerations. Some new investments have gone to expand or improve existing capacities, especially in natural monopolies (e.g. beverages, cement). Such expansion may have been stimulated by the short-lived spurt of growth that caused much euphoria, but is now fading away. In either case, such investment is likely to taper off soon, as already seems to be the case in a number of African countries. For example, FDI to Ghana, once hailed by the BWIs as a "success story", peaked in the mid-1980s, mainly due to privatisation, with negative outflows more recently.

Also, highly speculative portfolio investment was attracted by temporary "pull factors" such as high real domestic interest rates on Treasury Bills to finance budget deficits as well as temporary export price booms which attracted large export pre-financing loans (Kasekende *et al.* 1997). Mkandawire (2002), notes with concern, the predominance of portfolio over direct investments, and acquisitions over "green field" FDI, as possibly unintended consequences of the FDI policies adopted. Much recent FDI has involved acquisitions encouraged by privatisation, often on "fire sale" terms. Such investments, which have declined since the late 1990s, accounted for about 14 per cent of FDI flows into Africa.³ Meanwhile, there has been relatively little for new productive enterprises.

Incredibly, Africa is probably a net exporter of capital. In 1990, 40 per cent of privately held wealth was invested outside Africa (Collier and Gunning 1997; Collier *et al.* 1999;

² As Mkandawire (2002) observes, this paper seeks to "help boost SSA's image as an investment location" (Pigato 2000: 2), explain the positive conclusions painstakingly promoted with data suggesting otherwise.

³ In 1998 alone, privatization in SSA attracted US\$684 million of FDI (UNCTAD). Such one-off sales explain the jump in FDI in recent years, but by 1999, privatization-related FDI slowed down.

quoted by Mkandawire 2002). In the period 1970-96, capital flight from sub-Saharan Africa came to US\$193 billion; with imputed interest, the total goes up to US\$285 billion (Boyce & Ndikumana 2000), compared to the combined debt of US\$178 billion in 1996 (Mkandawire 2002). Ndikumana & Boyce (2002) argue that capital flight from Africa has been largely debt-fuelled.

Even World Bank economists concede that the effects of financial liberalization have been "very small" (Devajaran, Easterly and Pack 1999). Incredibly, they argue that capital flight may indeed be good for Africa: "The much-denigrated capital flight out of Africa may well have been a rational response to low returns at home.... Indeed, Africans are probably better off having made external investments than they would have been if they invested solely at home!" (Devajaran, Easterly and Pack 1999: 15-16). The BWIs conclude that there is "over-investment" in Africa. Devajaran, Easterly and Pack (1999: 23) argue that "we should be more careful about calling for an investment boom to resume growth in Africa... [and] about Africa's low savings rate..., [p]erhaps... due to the fact that the returns to investment were so low. Also, the relatively high levels of capital flight from Africa may have been a rational response to the lack of investment opportunities at home". As Mkandawire (2002) comments, this conclusion ignores the obvious fact that the social benefits of citizens investing in their own country may exceed the private benefits accruing to individuals.

African countries had been largely "adjusted" by the late 1990s, with major changes in African economic policy and institutions. Africa has been "liberalized" and opened to "globalisation". Most African countries experienced currency devaluations, trade liberalization, privatisation as well as various market and investor friendly policies. Apparently, improvements in the terms of trade and favourable weather conditions explained much more than the BWI policies, underlining the continued vulnerability of African economies to external factors. In any case, growth rates had begun to falter by 1997.

The deflationary bias of the macroeconomic policies favoured by the Washington consensus has put African economies on a low growth vicious cycle. Keynesians argue that the causal chain is from growth to investment, and not the other way around. El Bedawi & Mwega (2000) and Mlambo & Oshikoya (2001) have found that the causality runs from growth to investment in Africa as well. Capital needs are essentially determined by expected output, i.e. investment demand is driven by expected growth. Meanwhile, "endogenous growth theories" suggest that some "determinants of growth" may themselves be themselves dependent on growth.

Mkandawire (2002) argues that successful adjustment in Africa placed the continent on a "low growth path". He notes that the oft-invoked "determinants" of growth (e.g. income growth) are themselves determined by growth (Macpherson and Goldsmith 2001), including the global growth slowdown of the last two decades (Easterly 2000). There is strong evidence that growth has been slower in the 1980s and 1990s with

liberalization and globalization in most of the developing world, including sub-Saharan Africa, compared to the previous two decades (Weisbrot, Baker, Naiman, Neta 2000; Weisbrot, Naiman & Kim 2000; Weisbrot, Baker, Kraev, Chen 2001). Slower growth can be attributed to the deflationary bias inherent in BWI stabilization and adjustment programmes.

The investment patterns induced by economic liberalization measures appear not to be associated with high economic growth. Historically, investment, growth and productivity have moved together, e.g. investment was associated with relatively high growth and significant total factor productivity gains in the pre-adjustment era (Rodrik 2001). The transformation due to economic liberalization has brought economic stagnation, de-industrialization and agricultural decline, rather than structural change induced by differential productivity gains and changing demand due to increasing incomes (Mkandawire 1988; Singh 1987; Stein 1992; Stewart 1994). *Institutional Investor* ratings for Africa deteriorated from 31.8 per cent in 1979 to 21.7 per cent in 1995 (Collier and Gunning 1997). The two countries that performed well were Botswana and Mauritius, both high growth economies not pursuing orthodox adjustment programmes.

When most other developing economies embarked on import substitution industrialization, most of Africa was still under colonial rule. In fact, the import substitution phase was relatively very short, lasting barely a decade in many countries (Mkandawire 1988). Thus, economic liberalization policies prematurely exposed African industries to global competition, causing de-industrialization. UNIDO notes that African countries had been increasingly gaining comparative advantage in labour intensive manufacturing. However, given the BWI presumption that import substitution in Africa was bad, there was no attempt to see how existing industries could be the basis for new export initiatives. Assuming that African import substituting industries had been protected for far too long, and would never become viable, let alone competitive, the policy was simply to abandon existing industrial capacity.

Hence, the share of manufacturing in GDP has fallen in two thirds of the countries (Mkandawire 2002: Figure 4). The rates of growth of manufacturing value added have fallen continuously from the 1970s, and actually contracted by an annual average of one per cent during 1990-97 (UNIDO: 245, quoted in Mkandawire 2002). UNIDO found that in ten industrial branches in 38 African countries, labour productivity declined by seven per cent between 1990 and 1995. The decline in total factor productivity can be attributed to de-industrialization.

The "new trade theories" and evolutionary studies of technological development suggest that countries risk being "locked" into permanently slow growth by pursuing static comparative advantage. Verdoon suggested that economic growth precedes export growth, while UNCTAD has long pointed to the importance of growth for trade expansion, more specifically, an investment-export nexus that accounts for the failure

of many countries to expand and diversify their export base. Rapid resource reallocation may not be feasible without high rates of growth and investment.

Table 1: Africa: Savings and Investments, 1975-1999 (as % of GDP)

Indicator	1975-84	1985-89	1990-97	1998	1999
Gross Domestic Savings (GDS)					
Sub-Saharan Africa (SSA)	21.3	18.2	15.9	16.0	15.8
SSA minus S. Africa & Nigeria	15.3	13.4	11.1	12.7	12.6
Gross National Savings (GNS)					
Sub-Saharan Africa (SSA)	17.9	13.3	11.0	13.3	12.1
SSA minus S. Africa & Nigeria	12.1	8.4	4.9	10.4	8.5
Resource Transfer (GDS-GNS) Abroad					
Sub-Saharan Africa (SSA)	3.4	4.9	4.9	2.7	3.7
SSA minus S. Africa & Nigeria	3.2	5.0	6.2	2.3	4.1
Gross Domestic Investment (GDI)					
Sub-Saharan Africa (SSA)	22.9	17.7	17.3	18.8	18.4
SSA minus S. Africa & Nigeria	19.9	17.3	16.9	19.2	19.4
Resource Balance					
Sub-Saharan Africa (SSA)	-5.0	-4.4	-5.9	-3.0	-2.6
SSA minus S. Africa & Nigeria	7.8	4.0	5.9	-6.3	-6.3

Source: (World Bank 2001a).

Before the recent liberalization measures, policies in East Asia ensured that relative prices will be favourable to export industries (instead of non-tradables) and that interest rates supported investment and economic restructuring. Export promotion strategies have generally involved an investment-export nexus, including measures to promote public investment, subsidized inputs (from state-owned enterprises and by special exchange rates), direct subsidies (including tax incentives), selective credit allocation and other industrial policy instruments (Akyüz 1996). Government instruments for stimulating investment and industrial development have been severely eroded by economic liberalization measures.

Mkandawire (2002) notes that, from the outset, the advent of the WTO trade regime was predicted to entail losses for Africa, especially with the loss of preferential treatment (from its erstwhile colonial masters and the European Union under the Lome Convention). Trade liberalization under WTO auspices has significantly eliminated policy options utilized by developmental states, especially for industrial or investment policy (Adelman and Yeldan 2000; Panchamukhi 1996; Rodrik 2000a), though some

(e.g. Amsden 1999) argue that the WTO regime still leaves room for industrial policy initiatives.

A major premise of the Berg Report was that Africa's comparative advantage lies in agriculture. If only the state would stop "squeezing" agriculture through marketing boards and price distortions, African agricultural producers would respond so as to enable export-led growth. Recent changes in Africa's exports indicate no general increase in output in industries in which African countries ostensibly have a "revealed" comparative advantage. Indeed, after two decades of reforms, the most striking trend has been a lower African share of global non-oil exports to less than half of what it was in the early 1980s (Ng and Yeats, quoted by Mkandawire 2002).

In the last three decades, Africa's export collapse has involved "a staggering annual income loss of US\$68 billion – or 21 per cent of regional GDP" (World Bank 2000, quoted by Mkandawire 2002). However, "Africa's failures have been developmental, not *export failure per se*" (Helleiner 2002a: 4). Rodrik (1997) notes Africa's "marginalization" is not due to trade relative to GDP, although this is low by cross-national standards. Given its geography and its per-capita income level, Africa trades as much as is to be expected. Indeed, "Africa overtrades compared with other developing regions in the sense that its trade is higher than would be expected from the various determinants of bilateral trade (Coe and Hoffmaister 1999; Foroutan and Pritchett 1993).

Meanwhile, by the end of the 1990s, the few gains from trade generally acknowledged were of a one-off character, often reflecting switches from domestic to foreign markets without much increase in overall output (Helleiner 2002a, 2002b; Mwega 2002; Ndulu *et al.* 2002). In some cases, manufactured exports increased even as the manufacturing sector contracted. "No major expansion occurred in the diversity of products exported by most of the Sub-Saharan African countries.... Indeed, the product composition of some of the African countries' exports may have become more concentrated. Africa's recent trade performance was strongly influenced by exports of traditional products which appear to have experienced remarkably buoyant global demand in the mid-1990s" (Ng and Yeats: 21, quoted by Mkandawire 2002).

4. NEW CHALLENGES

Major developments since the 1980s have fundamentally changed the environment and conditions for developmental states attempting to pursue selective industrial or investment policy. Most importantly, economic liberalization -- at both national and international levels -- has seriously constrained the scope for government policy interventions, especially selective industrial promotion efforts. This is especially apparent in international economic relations, but is also true of the domestic policy environment, where WB and IMF policy conditionalities as well as WTO and other

obligations have radically transformed the scope for national economic policy initiatives.

There has been a widespread, sweeping and rapid opening up of trade, investment, finance and other flows. Very often, such liberalization has been externally imposed by the Bretton Woods institutions as part of conditions imposed to secure access to emergency credit during the debt crises of the 1980s, and more recently, in the wake of more currency and financial crises. Various policy packages for (price) stabilization in the short term or for structural adjustment in the medium term have involved such conditionalities. The new intellectual and policy environment which emerged during the 1980s – under Reagan and Thatcher – culminated in the so-called 'Washington Consensus', which has promoted such policy reform.

This has been especially true of much of Latin America and Africa, which experienced a 'lost decade' of economic growth in the 1980s following the (sovereign) debt crises and the ensuing 'stabilization' and 'structural adjustment' reforms, usually imposed by the international financial institutions (IFIs). The 1990s were only slightly better, with a few spurts of high growth here and there which have been touted as proof of the success of the Washington Consensus, when precisely the opposite has been true. While the Washington Consensus has been challenged, if not discredited in academic circles, it continues to constitute the ideological basis for economic analysis and policy-making in developing countries, especially in Africa, Latin America and other smaller economies.

Invariably, the circumstances of such policy changes as well as the limited policy capabilities of the governments concerned have meant that little preparation—in terms of a pro-active strategy or transitional policies to anticipate and cope with the implications of sudden exposure to new international competition—has been undertaken. Few of the investment policy instruments of the past are viable or feasible options today, including many that were used successfully in different circumstances in post-war East Asia. However, it should be noted that most of the main industrial policy tools still available today have already been intensively used by most advanced industrial economies, including those that currently reject selective industrial promotion. Indeed, most advanced economies have a plethora of policies and institutions involved in research and development (R&D), skills training, investment promotion and infrastructure provision, e.g. for the new information and communication technologies (ICT).

Such policies are probably necessary, but certainly not sufficient for stimulating and sustaining economic growth and structural change for developing countries to try to 'catch-up'. Additional policies are urgently needed to prevent such economies – already at a historical disadvantage in various respects – from falling further behind the industrially more developed economies of the North, as well as the other newly industrial economies that have emerged in recent decades. This final part considers the challenges that face African economic policymakers as a consequence of

globalisation, technological change and debates about the role of the state itself by drawing on East Asian experiences.

Globalisation

More than ever before, recent globalisation in the last two decades has primarily served the oligopolistic interests of trans-national corporations (TNCs). TNCs are now believed to account for about two-thirds of international trade. About 40 per cent of such trade takes place within—rather than between—companies. Since the 1980s, internationally integrated production systems (IIPS)—often described by other terms such as 'manufacturing value chains'—have grown faster than other contributions to international trade expansion. Thus, new, often changing specialization or divisions of labour have emerged internationally, based on differences in wages, skills, technology and logistics.

With the growth and spread of TNCs, 'green-field' FDI has been rising rapidly, faster than overall production and trade, as well as domestic investment. During the 1990s, mergers and acquisitions (M&As) have come to account for most FDI. While M&As do not add anything to productive capacity in and of themselves, they have contributed to the growing international integration of production.

Domestic economic and technological capabilities have increasingly become important determinants for attracting FDI. Such capabilities may be reflected in the form of internationally competitive industrial firms or clusters. As Sanjaya Lall has put it, effective globalization relies on efficient localization. In order for investment, growth and structural change to be sustained, it is necessary for the domestic investment environment to be attractive, requiring significant coordinated pro-active efforts by the local authorities. There is strong evidence of heavy concentration of FDI, particularly in the more sophisticated activities involving greater value addition and worker incomes. But with a few exceptions, there is little reason to believe that such FDI has any particular interest in investing in most of Africa in the present circumstances.

Technical Change

Given the pervasive and rapid nature of technical change, coordinated pro-active efforts are needed as private agents are unable to respond adequately to new situations and challenges, and certainly not in the coordinated fashion needed to address the diverse needs of selective investment promotion efforts in the new circumstances. Some of the new circumstances to be considered, according to Lall, include the following:

- 'Compression of space' with lower and declining communication and transport costs, as well as faster services.
- Greater information availability: more information on a greater range of issues is more easily available, and this is likely to grow, rather than recede.

- As markets become much more integrated, new threats posed by greater and sudden competition tend to outweigh the new export opportunities offered by greater access to larger markets, unless the economy has been adequately prepared through appropriate pro-active measures.
- Economic activities have become more technology-intensive, offering potential new benefits (e.g. in terms of technological learning, productivity gains, technology spill-over benefits, management flexibility) for those adequately prepared, but placing others at greater disadvantage. The new technologies require new skills, management, institutions as well as infrastructure. Using the new technologies effectively and efficiently also requires greater domestic technological capabilities as well as new forms of specialization and organization.

According to Lall's survey of the developing world, East Asia currently leads in terms of economic performance, with fastest growth, greater exports as well as technology intensity. He also notes the great divergence between those East Asian countries with and without selective investment policy, and finds the latter (mainly in Southeast Asia) far more vulnerable.

In contrast, while some more industrialized Latin American countries have developed strong industrial capabilities and skills as well as ICT infrastructure, technology structures as well as R&D remain weak. FDI has been high in some Latin American countries in recent years, but much has been in the form of M&As. Even green-field FDI has not been as dynamic in transforming technological structures and capabilities, as in Singapore or China. There is little evidence to suggest better prospects for FDI in Africa. Development prospects for Africa are generally quite poor because of inadequate and inappropriate pro-active investment policies due to the influence of the neo-liberal Washington Consensus.

Clearly, industrial development in the new circumstances requires international competitiveness, and such competitiveness is increasingly defined in many regards in manufacturing and related services and institutions, and not simply in terms of wage costs or exchange rate competitiveness, as important as these may be. Inability to compete effectively implies being by-passed, and ultimately, stagnation at the lower end of the technological and income ladder. In light of existing African industrial capacities and technological capabilities, it is difficult to imagine how trade liberalization can enhance African industrial development.

Globalisation and liberalization have led to growing industrial and technological divergences reflecting differences in industrial competitiveness. Industrial rationalization at the global level—with growing globalisation and liberalization—is likely to lead to a concentration of a few major production locations, particularly for successful first movers with strong technological capabilities and industrial agglomerations. Market forces strengthened by economic liberalization cannot be relied upon to check—let alone reverse—such differences in international competitiveness. For the few countries that successfully participate in such globalised

production, sustaining growth will increasingly depend on upgrading industrial skills and indigenous technological capabilities, which cannot be assured by previous achievements alone.

New Role for the State

The major transformations of the recent period have very significant implications. While economic liberalization at international and national levels undoubtedly constrain and limit investment policy options, the new circumstances pose new challenges that can only be adequately and successfully met and overcome with appropriate pro-active investment policy measures. Pro-active selective investment promotion measures are, therefore, especially needed to enhance competitiveness in the face of pervasive market and institutional failures, as well as growing recognition that while market mechanisms may be efficient in static allocation terms, the main challenge for development remains the transformation of a country's comparative and competitive advantages in a dynamic sense. The new circumstances also imply that new investment policy strategies will have to be quite different from previous investment policy in order to be able to address the new challenges.

The compression of space and time—often associated with the contemporary 'post-modern' era—has profound implications for economic policy making. New information, communication and transportation technologies and lower associated costs have reduced and transformed the significance of geographical distances and related time considerations in production and distribution.

Meanwhile, rapid technical change and the changing significance of technological advantages—reflected, for example, by strengthened (monopolistic) intellectual property rights—have heightened the significance of technological capabilities, and hence, education, training, research, design and development. Greater international integration of production processes has also dramatically transformed policy options for governments desiring not to be left behind.

Pro-active selective industrial promotion measures are, therefore, especially needed to enhance competitiveness in the face of pervasive market as well as institutional failures, as well as growing recognition that while market mechanisms may be efficient in static allocation terms, the main challenge for development remains the transformation of a country's comparative and competitive advantages in a dynamic sense.

While economic liberalization is often associated with deregulation at the national level, it has actually involved greater regulation at the international level through a variety of inter-governmental (IMF, WTO, etc.) as well as private organizations (Bank of International Settlements; standards setting bodies). Meanwhile, market forces have become very real in the sense that seemingly impersonal market mechanisms, often dominated by major market players (powerful TNCs), have been increasingly

able to require other market players (including governments) to conform through subtle means such as the implied threat of exclusion or 'downgrading'.

Economic liberalization, freer markets and more mobile economic resources do not render 'industrial' or 'investment policy' obsolete, but rather require new feasible and viable investment policy options in the face of the new challenges and constraints. The development of better as well as more suitable indigenous technological capabilities can only be—irresponsibly—left to markets, which are not capable of being pro-active for development purposes. The main focus of new investment policy must be on building technological capabilities—in existing activities as well as in more sophisticated new activities characterized by high growth and greater technological and other spill-over benefits.

All this is not to suggest that there is one investment policy formula for all economies over time. Instead, precisely the contrary is true, i.e. context is all important. For example, the degree of reliance on FDI must necessarily vary with domestic considerations, i.e. existing resources and strengths, as well as perceived inadequacies and the likelihood of such weaknesses being addressed by the presence of FDI. But even the policy outcome of such an assessment must be subject to continuous review, with policy changing with experience as well as changing circumstances.

There is no room for dogma, but strategic pragmatism should prevail instead. In any case, as Lall reminds us, appropriate investment policy will require selective interventions as well as effective co-ordination among firms, clusters and factor markets, which should presumably be consistent with a clear and coherent 'vision' of the future as well as the 'road-map' towards policy goals. For this purpose, there are still many useful lessons to be drawn from the varied experiences of the more successful East Asian NIEs and China, as well as the more modest and flawed achievements of the Southeast Asian NICs.

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