Review Essay

Answers to Questions on Asian Development

Gonzalo M. Jurado

Current Issues in Economic Development: An Asian Perspective. BY M.G. QUIBRIA AND J. MALCOLM DOWLING (eds.). Oxford: Oxford University Press, 1996.

One will be hard put to think of a group of countries more heterogeneous than those of Asia. China has a population of 1.2 billion inhabiting some 9.6 million km^2 of land while Brunei Darussalam has 280,000 people occupying some 6,000 km^2 of territory. Sri Lanka and Thailand are Buddhist; Indonesia and Malaysia are Muslim; while the Philippines is Christian. In 1994, Singapore had a per capita Gross National Product (GNP) of US$23,000 and Nepal US$200. As diverse as they are, however, Asian countries face the common problem of accelerating and sustaining their economic development.

Solving the common problem of speeding up and sustaining economic development in the current Asian context involves making a number of concrete policy choices. In the arena of international relations, the countries must decide on whether or not their trade with other countries should be liberalized. On the domestic front, they must, among others, decide on how to maximize the contribution of their government to the development effort. They must lay down a clear-minded policy on population to ensure that population enhances rather than retards the economy's growth potential.

These issues are extensively discussed in Asian countries and certainly in the Philippines. But if the exchanges have produced no consensus, it is because the answers are not clear-cut. Trade liberalization may yield unambiguous benefits to the economy, but it can prejudice some enterprises no less than it can favor some. Some firms may vanquish their competitors while some may lose out in the global struggle. Some jobs may be gained but some may be lost. In this situation, arguments for the continuation of protection may be difficult to resist.

Maximizing the contribution of government to the development effort can mean mobilizing the potential of democracy for carrying out decisive action but it can also require exercising the arm of authoritarianism to produce results. How much of the one and how much of the other? One recalls the lecture of Senior Minister Lee Kuan Yew of Singapore to a Philippine audience a few years ago which expressed skepticism of the effectiveness of democratic processes in the promotion of economic growth.

Getting the most from government can also be interpreted as requiring the scaling down of bureaucracy, perhaps through privatization, in order to give government programs sharper focus; or alternatively, as demanding the enlargement of its scope in order to meet the people's multifarious requirements. The benefits of privatization are also not too obvious, especially in cases of natural monopolies. Some would argue that where natural monopolies exist, regulation may be the preferred approach.

With regard to the population-development nexus, it is not certain whether economic development determines fertility rates or fertility rates determine the pace of economic change. In other words, which one is the dependent and which one is the independent variable? Whatever it may be, couldn't something be done at the individual family level here and now as we await the favorable impact of economic development at the national level?

The present volume should be welcome reading to all who are seeking a resolution to issues of governance, democracy, corruption, ethics and values, privatization, liberalization, participation in the World Trade Organization (WTO), foreign investment, population, and the environment – and their impact on economic development. The book contains ten essays presented by distinguished economists in an international conference on development economics held by the Asian Development Bank in Manila in November 1994. It opens with an overview chapter written by editors M.G. Quibria and J. Malcolm Dowling. It is a well-written and carefully thought-out chapter describing the geographical, population and politico-economic features of Asian countries which provide the concrete background for the individual essays. It then provides an analysis of the issues that currently confront Asian countries together with a review and summary of the essays presented in the volume. Readers not inclined to tackle technical details of the individual essays can limit their reading to this excellent chapter without depriving themselves of essential knowledge. Graduate students writing their thesis will not, of course, have this option. They will just have to read everything, including the footnotes.

Using the classification scheme of the overview chapter, one can group the individual papers under three headings: (a) governance, democracy, corruption, and ethics (papers by Paul Streeten, Robert J. Barro, Abhijit Banerjee and Basant Kapur); (b) regulation, privatization, the trading environment, and economic development (Jean Jacques Laffont, Rodney E. Falvey, T.N. Srinivasan, and Motoshige Itoh and Jun Shibata); and (c) population, the environment, and agricultural development (Marc Nerlove and M. Ali Khan). While all the papers are substantive, a testimony to the reputations and scholarship of the authors, the present review will touch only on those by Streeten, Laffont, Falvey and Khan because they dwell directly on matters of great interest in the Philippines.

STATE INTERVENTION

In his paper, "Governance," Streeten deals with a wide variety of problems and takes positions on them. In opposition to the view that efficiency, equity and liberty call for minimum state intervention, he argues that strong and, in many cases, expanded state intervention (of the right kind, in the right areas) is necessary in order to make markets work. Among the actions that an expanded state should take are those that "get prices right;" provide a legal framework and maintain law and order; pursue correct macroeconomic policies with respect to exchange rates, wage rates, and trade policy in order to ensure high levels of employment without inflation; encourage competition by anti-monopoly and anti-restrictive practices legislation; set up competitive enterprises in the public sector, and liberalize trade or take over natural monopolies.

Getting prices right is a major responsibility of government, Streeten says. He points out that there is nothing in the nature of free markets that either establishes or maintains competition. On the contrary, quoting Adam Smith, he argues that free markets make for conspiracies against the public. This, of course, is the opposite of contemporary doctrine which sees the free market as establishing "right" prices and the government as "distorting" them.

The functions of government, as Streeten puts it, include the construction of physical infrastructure and the development of human resources, universal health care, environmental protection, promotion and dissemination of basic research, promotion of racial justice, public schools, renewal of cities, rehabilitation of the homeless, provision of jobs and so on.

Streeten also has something to say on the relation between democracy, capitalism, and development. He argues that

> when the invisible hand of the market causes suffering through excessive unemployment or exploitation or environmental degradation, democracy demands interventions with the free market. There is no evidence whatsoever that these interventions are bound to lead to slavery and despotism, as Friedrich von Hayek predicted. On the other hand, the owners and managers of private firms attempt to restrain democracy when it claims too many resources for mass consumption.

Streeten stops short of saying, however, that democracy has a positive impact on development. He does make insightful comments; but these are not likely to satisfy the minimalists. The point, the minimalists would say, is precisely that state intervention is seldom "of the right kind, in the right places." They have history on their side, at least in the Philippines.

PRIVATIZATION

For his part, Laffont examines the trend towards deregulation and privatization, noting that while there is agreement that some form of intervention is required in the case of natural monopolies, consensus is lacking on the nature of the intervention or the real domain of natural monopolies. His paper, "Regulation Privatization, and Incentives in Developing Countries," is an argument in favor of regulation of natural monopolies in developing countries taking into central consideration, however, the financial and institutional capabilities of these countries. At this time, developing countries suffer from the high costs of public funds, a high cost of auditing, weak constitutional control, difficulties in committing to long-term contracts and, lastly, poorly developed credit markets.

Laffont argues in favor of regulations with low-powered incentives, except in the case of a bad auditing mechanism. He suggests a three-stage procedure. In the first stage when the auditing system is weak, incentive schemes should be strong. In the second stage when auditing has improved, incentive schemes should be weak. And in the third stage, incentive schemes should be stronger than in the first stage. He concludes that developing countries would need to establish a credible and stable set of regulatory rules to ensure the success of their privatization programs for natural monopolies. Such rules should safeguard against future political interference to guarantee the continuity of the incentive system, if not its improvement over time.

Laffont's recommendations are well taken but they are not pertinent to the issues in the Philippines. Here, the enterprises which the state is privatizing are mostly those that the government had to foreclose because their previous private owners failed to settle their financial obligations to the government. At the same time, the only natural monopoly which the government has privatized, the Metropolitan Waterworks and Sewerage System, had been so inefficiently managed by the government from the very beginning that no one, except the incompetent employees who stand to lose their jobs, is lamenting its recent transfer to private hands.

LIBERALIZATION

Falvey writes on a topic that is at the center of debate in the Philippines: trade liberalization. He begins his paper, "Trade Liberalization and Economic Development," by noting that, in the last two decades, trade policies of developing countries have been shifting away from inward-oriented import substitution (IS) policies toward more outward-oriented export promotion (EP) policies. The IS trade strategy was broadly justified in the 1950s and the 1960s when conventional wisdom in development economics pointed to the domestic market occupied by imports as a potentially large market for locally produced import-replacing output. Unfortunately, however, the strategy, as observations suggested, failed to realize its objectives which included the major one of improving growth performance. In contrast, the EP strategy seemed to produce outstanding results in terms of export earnings, efficiency of domestic industries and, ultimately, per capita incomes in the countries where it was pursued.

If economic success hinged upon it, says Falvey, then suggesting that there be more "openness" to developing countries is important from the viewpoint of policy. Forthwith he evaluates a vast amount of empirical econometric material that examines the "openness" and development connection. While he finds a lot to criticize in the material, starting from definitions, appropriateness and quality of data used, to interpretations (correlation does not imply causality, among others), he could not avoid the conclusion that "a careful reading of these studies would make it difficult for even a skeptical reader to conclude that trade liberalization does not hold favorable implications for growth."

Falvey, at the same time, finds the neoclassical growth model more powerful in explaining growth in per capita income. In this model, physical capital accumulation, human capital accumulation, and investments in research and development are the critical variables explaining per capita income growth. The implications of this framework for trade and trade policy are numerous and complex. Differences in the levels of the variables will imply differing comparative advantage among countries across space. Also, depending on changes in factor accumulation and R&D, comparative advantage may shift among countries over time.

Falvey's conclusion is carefully qualified. The weaknesses and incompleteness of the various trade policy and growth studies, notwithstanding, "all the evidence suggests that open economies grow more rapidly. Until such time as the more recent propositions on growth have been adequately verified, the basic role for trade policy would seem to be one of keeping open the channels through which international spillovers might flow."

This is a masterful review of the state of scientific knowledge in international economics and one would hope that it convinces skeptics. But if it does not, it can only be that, as the old saying puts it, no one can be persuaded against his will.

DEMOGRAPHIC TRANSITION

Finally, "Population and Economic Development" by Khan traces the twists and turns of the concept that has played a key role in establishing a relationship between population and economic development: the concept of the demographic transition. The transition, described in its "canonical" form, classified all societies in three ways: pre-industrial agrarian, transitional growth, and incipient decline. At the first stage, agrarian societies have high and static fertility, this being a response to high mortality rates. As society industrialized, it moved to the second stage, where mortality rates fall. The full effects of modernization become evident only in the third stage, when fertility rates fall, and the population moves into the final stage of incipient decline. In this formulation, declines in both mortality and fertility are an inevitable consequence of industrialization and hence of economic development. In other words, population is the dependent variable and economic development the independent variable.

By 1950, Khan notes that, in what is now known as the orthodox version, the variables had exchanged places "and population growth came to be seen as the stumbling block to economic development." In this version, "demographic variables became determinants of economic trends: rapid population growth became a cause of continued underdevelopment; and fertility as a variable had to be lowered by policy interventions."

Apart from the canonical version and the orthodox version of the demographic transition, a third approach, now known as the economic framework, would apply standard consumer behavior theory to a family's decision concerning its size. In consumer theory the economic agent tries to improve its welfare by comparing benefits of commodities and costs of these commodities. In the new framework, the family comes to a decision as to its size by comparing the benefits of having children with the costs of raising them, deciding to have more (less) children so long as the benefits exceed (fall short of) the cost of child-rearing.

The "commodification" of children has not gone unnoticed. While it has heartened the adherents of the approach, it has drawn criticism from its opponents. Says Duesenberry, as quoted by Khan: "I submit... that most couples would consider they have a very narrow range of choice...[regarding] the number of children and expenditures per child. I suggest that there is no one in this room...who considers himself free to choose either two children who go to university or four children who stop their education after high school."

All the same, the economic approach has gained currency in demographic-development research. Many would continue to be repelled by the commodification framework but the approach, for the first time, brings the issue into the ambit of individual decision-making carried out in the context of prevailing socioeconomic conditions. This indeed may be the most important contribution of the economic approach.

At the end of his odyssey, Khan asks whether he has produced any straightforward guides to policy. He is not too sure. He concludes: "Problems of population and economic development come wrapped together; the solutions need balance and judgment, and, for maximal efficiency and sustainability, ought to emerge from within the societies for which they are prescribed."

Khan is being too timid. Earlier, in a 1948 document authored by Notestein, as noted by Khan, a conceptual distinction was made between "the *first order* deeply embedded forces that maintained large *inter*-national differences in overall fertility levels between cultures, and a finer set of *second-order intra*-national factors that might produce observable and manipulable variation in fertility behavior within a single cultural regime." Whereas the first-order factors are slow to change, the second-order forces are susceptible to immediate influence. Cannot the second-order variables be modified, say with family planning methods, while the first-order ones – the forces of large-scale economic development – are taking time to exert their impact? Is there a contradiction between the two?

If a criticism is to be leveled at this book, it is that its authors, with regard to some questions, are much too shy to give unambiguous answers which policymakers and practitioners can quote to silence relentless public tormentors. But such is the nature of science. As somebody has said, science does not grow by leaps and bounds.

Will this book answer all the questions affecting public policy in the Philippines? Not by a long shot, but it will go a long way in clarifying many of today's issues that are being debated with more noise than light.