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General proposition

East Asian "Tigers" managed to sustain fast rates of growth for more than three decades, and avoid the worse effects of the debt crisis and oil price boom because of two major factors: (i) the quality of government intervention; and (ii) the structural characteristics of their economies, namely trade balance promoted mostly through industrial policy, and fiscal balance due to high rates of savings.

Trade balance and industrial policy

Neo-liberals explain the East Asian success in attaining trade balance despite very fast growth rates by arguing that EA did well export-wise because they liberalised trade. This argument is based on the notion that production does not start until there is comparative advantage, and that exports also start immediately with production because there is no more than a very brief period of learning-by-doing before firms become competitive. In brief, firms are born competitive.

The problem arises if: (i) comparatives advantages emerge from production experience, rather than the other way round, so that firms have to start production before they acquire comparative advantages; and (ii) exports require more than comparative advantages, but mostly the knowledge, experience, the reputation and finance to penetrate international markets often shaped by strong competition between dominant international firms. In this case, there is a time lag between starting production and acquiring comparative advantages; and between acquiring comparative advantages and starting to export. The magnitude of this time lag varies with the technological and market complexity involved in each particular industry. Thus, the time lag is larger the more knowledge and innovation intensive the industry is. On the other hand, it is in these industries that the scope for improving and fast growth of production and exports is longer. Thus, fast and sustained innovative industrial progress is associated with longer time lags between production and comparative advantages and these and exports.

In this case, protection and subsidies are justified to help investment, learning and innovation to take place, and ISI and EOI become intrinsically and organically integrated. This is so for various reasons. First, exports cannot start before production becomes competitive, which cannot happen before production starts. Thus, in order for production to start and export capacity to be created ISI means of industrial policy may have to be adopted. Second, exports and domestic demand are both part of a global market. Third, exports into new markets provide the finance, the ability and the experience and knowledge to upgrade industry into new stages through initial ISI towards expanding market access via exports.

The question that has to be solved is how to ensure that industries upgrade and become more competitive during ISI in order to expand their market access continuously through EOI.

The EA experience shows that industrialisation and economic growth can be achieved if:

- *ISI and EOI are organically linked.* If countries only promote ISI, they may create unsustainable and inefficient economic structures, unable to compete in international markets. If they only promote EOI, they are bond to be limited to static comparative advantages with no much scope for upgrading and improvement. Therefore, it is the combination of the two, rather than one or the other, that creates dynamic capital accumulation;

- *Incentives are conditional to performance targets*, so that business receives the resources necessary for its development but are submitted to the discipline of performance indicators (ex, export share of output, acquisition and mastering of particular technologies, etc);
- *Investment is coordinated and risk shared* such that the economy diversifies and expands into new sectors, technologies and markets.

The lesson from EA is, thus, that ISI should be subjected to performance discipline.

Fiscal balance and the rate of savings

Neo-liberals argue that EA countries maintained economic balances because they avoided budget deficits and liberalised the financial system, thus through higher real interest rates promoted savings and improved the quality of investment.

The problem arises when this description does not match the empirical evidence. First, EA countries faced budget deficits, though not as high as in Latin America, and also they were capable of correcting for such deficits. Second, it is now generally known that high real interest rates do not promote savings but are effective at reducing investment. Third, and more to the point, the financial organization in EA responds to the needs of industrial policy and was constrained by the shape of industrial policy in each stage. It is a fact that interest rates in EA varied significantly across industries in different periods, all targeted industries received subsidised credit for working capital and strategic industries also received subsidised credit for fixed capital. Thus, the neo-liberal explanation does not hold.

Although research is continuing in this area, there are some tentative, alternative explanations for the EA ability to maintain financial balances under very fast growth rates.

One explanation argues that social control over both labour and capital (through the State) helped to moderate inflation even in the presence of fiscal deficits. Low inflation leads to higher rates of savings because the savings risk is reduced. On the other hand social control over labour and capital made income distribution more equitable, which in turn helped to reinforce social control. As savings increased inflation fell and so on. Thus, social control of labour and capital generated a dynamic process that multiplied savings and reinforced social control.

This dynamic of low inflation and high savings was reinforced by other three characteristics of economic change in EA: female participation in wage labour increased very significantly, thus increasing households ability to save; need to buy education also increased savings; and the need to buy houses was another factor in continuous high savings rate.

Another explanation for the financial balance under high growth rates is focused on the investment-profit nexus of the EA experience. Given that firms were profitable in both existing and new industries, a mechanism by which profits financed investment, expansion and diversification was developed. This nexus was also helped by government tax policies that gave incentives to reinvestment of profits into productive activities, and credit and licensing policies that encouraged firms to diversify and expand to new industries, technologies and markets.

Finally, given that income grew fast through fast industrialisation, savings also grew as they are significantly more responsive to income and investment opportunities than they are to interest rates.