

A Comparative Study of the Economic Performance of Latin America and Asian NIES

神戸大学大学院 Carlos Aquino

The decade of the 1980's has seen a striking difference between the economic performance of the Latin American and Asian NIES. The former (Brazil and Mexico) have shown negative per-capita economic growth rates while the latter (South Korea and Taiwan) have continued to show high economic growth rates. The purpose of this paper is to take a look at the reasons behind these differences in observed economic performance among these group of countries.

It has been pointed that the Latin American NIES have been following an Import Substitution Industrialization (ISI) model while the Asian NIES have adopted an Export Oriented Industrialization (EOI) model; and it is said that the different paths of industrialization strategy accounts for their different economic performance. In this paper, we hope to discuss the factors that have influenced the adoption of these different economic policies.

First, a review of the initial conditions which confronted these countries before the implementation of these economic policies is given. Second, a review of the economic policies themselves is given. Third, some conclusions and policy recommendations are noted.

I. Initial conditions

Before we begin the discussion, it should be stated that Hong Kong and Singapore were not within the scope of this study although they are part of Asian NIES. These are two small city-states that have long been playing a role as entrepot trade centers. These city-states have no

agricultural sector to speak of, have a small population and hence a small internal market. Under these circumstances, an industry oriented towards these internal markets cannot expect to survive. Therefore our discussion will concentrate only on Korea and Taiwan when talking about Asian NIES.

Geographically there are major differences between Latin American and Asian NIES. Latin American NIES are big countries in terms of territorial size, with a favourable endowment of national resources, big populations that give them a comparatively bigger internal market vis-a-vis the Asian NIES.

Historically, Latin American NIES achieved independence much earlier than Asian NIES. They had a head start in their industrialization efforts. The Asian NIES just became independent since the end of the Second World War when Japan was defeated.

Related to the long history of the Latin American NIES it is noted the existence of groups with vested interests like : landowners, opposed to the realization of an Agrarian Reform (Mexico began a Land Reform Program in the 1910's and continued it in the 1930's, but an Agrarian Development program was not fully implemented) ; industrialists, serving the internal markets ; labor unions, specially in the numerous state enterprises. These pressure groups will influence the government in the adoption of economic policies.

Vested interests are those of groups like industrialists that have an interest in keeping an ISI policy that means for them a closed market with no competition from abroad. They have a vested interest in keeping this ISI policy and oppose a change to an EOI policy that will force them to be competitive in foreign markets. Vested interests are those of labor unions that would prefer an ISI policy instead of an EOI because the latter means use of cheap, docile labor force and so labor union demands for salary increases will not be allowed. These groups with

vested interests exert pressure and demands on the government.

In the case of the Asian NIES, these countries began an independent life with strong governments and without the existence of pressure groups. Agrarian Reform carried out in Korea and Taiwan wiped out landowners. The war fought in their territories destroyed the incipient industries and the industrialists as a group. Strong, military governments did not allowed the activity of labor unions. Governments were relatively free to implement and change economic policy.

Special mention should be made to the Agrarian Reforms carried out in the Asian NIES. It is said that the favourable income distribution found in these countries is the result of: the land reform program, the early emphasis on labor-intensive employment, easy access to education and a high degree of social mobility.¹

Agrarian Reform (and Land Reform is the first step in the process) allowed these countries to overcome some constraints to economic development.

First, it eliminates one of the most visible sources of income inequality, the existence of rich landowners and miserable landless peasants and generated a kind of social stability.

Second, it increased the saving available for economic development by increasing peasant incomes. This was achieved through increased production by the farmers supported by the State in terms of financing, commercialization, etc.

Third, it increased the supply of food by providing incentives for the production of subsistence crops thereby eliminating the need to spend scarce foreign exchange importing them. Even more, in the case of Taiwan, exports of agricultural products were stimulated and the agricultural sector contributed to the generation of foreign exchange. In the case of Latin America, export crops are grown in large estates with most benefits accruing to landowners and rich farmers, while

production of subsistence food is discouraged and need to be supplemented with costly imports.

Fourth, the equitable income distribution in Asian NIES stimulated a demand towards simple labor-intensive goods. In Latin American NIES, the skewed demand towards luxurious, capital-intensive goods initially originated from the existence of a small group of wealthy landowners.²

The adoption of different economic policies by these groups of countries, given the different initial conditions in economic development, will be analyzed below.

II. Policy Implementation

Latin American NIES adopted concrete industrialization policies after the Second World War.³ Before the Second World War, there was a more or less spontaneous import substitution of simple labor-intensive goods. By the 1940's the internal market became saturated for light industrial goods. The unequal income distribution made the extent of an expansion in the production of light industrial goods narrow. Under these conditions, there was the need to move to the production of durable consumer goods to continue the industrialization process. Also the persistent trade deficit due to the import of durable consumer goods and the reliance on export of primary goods to pay for that imports, made the adoption of an ISI policy of capital-intensive and durable consumer goods a reasonable alternative.

Governments gave all kinds of incentives to the domestic production of these capital-intensive goods. Transnational Corporations (TNCs) were welcomed to the protected internal markets. An indiscriminate import substitution without cost consideration were followed. Negative interest rates and overvalued exchange rates made the adoption of more capital-intensive methods an economic alternative. Also the activity of labor unions made the introduction of labor-saving techniques in the

production process a desired one.

The typical example of the assembly and manufacture of automobiles illustrate this industrialization process. Prohibitive tariff made impossible the import of this good. Tax reductions and other forms of incentives were given to promote domestic production. The Transnational Corporations (TNC) moved in time so as not to be tarified out of the market. They took advantage of the incentives offered.⁴

The objective of the ISI policy of avoiding continuous trade deficits through the replacement of imports by domestic production was not accomplished. The industries encouraged under this policy became more capital-intensive. Import of capital-intensive machinery were encouraged. Attempts to lower tariff protection to encourage a cost-competitive domestic industry were opposed by internal market oriented industrialists. Further, a correction of the overvalued exchange rate to encourage exports were opposed by this same group.

From now on we will state some of the factors that have influenced the industrialization process. The incomplete Agrarian Reform, as pointed out perpetuated an unequal income distribution. The industry developed was limited in its scope, because the large and poor segments of the population could not effectively demand industrial goods (light industry goods that correspond to the first stage of industrialization).

Although the industrial sector continued its development by moving to the production of durable consumer goods, the market for these products were limited. Only a small segment of the population can afford these goods. It is therefore not possible to achieve economies of scale in the production of these goods. Besides, the intermediate and capital goods industry is more limited because few industries demand their products.

It is suggested that the industrialization process followed was a vertical rather than a horizontal one. Vertical in the sense that the

industrial production moved from light to consumer goods, then to capital goods. Horizontal would mean trying to fulfill the extent of each stage of industrial production, reaching economies of scale, before moving to the next stage.

The low saving rate is partly a result of little or no contribution of the poor segment of the population to saving. With inadequate saving, private enterprise can not afford investment. That is the reason why the State has had an increasing participation in the economy and in the industrial process by establishing state enterprises, undertaking industrial investment.

The existence of primary goods to export also allowed for an overvaluation of the exchange rate in a typical "Dutch disease" phenomenon. This implies that as capital intensive industry develops, it is necessary to erect a high tariff barrier in order to offset the tendency to import goods competing with the domestic ones by the use of cheap foreign currency.

This cheap foreign currency characteristic will also discourage the export of manufactured goods. By the end of the 1960's in Brazil and Mexico some measures were introduced to encourage exports. A devaluation of the exchange rate and subsidies were employed, to achieve this. The problem is that the high inflation rates of these countries coupled with the high cost of domestic inputs used in the production of exportable goods offset the efficiency of these measures to encourage exports.

In the 1970's these countries borrowed large amounts of money from foreign sources. This money has not been used in proper investments, it was used to continue a consumption pattern or the subsidization of government services. By the 1980's with the lowering of prices of primary goods that these countries continue to export, and with less foreign exchange available, they became unable to service their external debt. Their industry is a foreign currency consuming industry, this

industry does not generate foreign currency because of lack of export competitiveness. With a foreign exchange constraint, and no more borrowing available, their economic growth rates have fallen down.

The big public sector and the numerous public enterprise are rather inefficient. These enterprises maintain a large payroll. To pay them, money is printed and this constitute one of the reasons for the acceleration of the inflation rates in these countries.

The Asian NIES at the start of their independent life pursued an ISI policy of light industry goods. By the end of the 1950's their small internal market became saturated. They could have moved to the ISI of capital-intensive goods like the Latin American NIES but they did not.

The Asian NIES governments implemented an EOI policy. The national currencies were devalued, interest rates raised (but preferential, low interest loans for export industries were set up) duty free import of inputs, needed for the production of exportables, were allowed. They promoted labor-intensive export industries in order to earn the needed foreign exchange.

Why did Asian NIES implement an EOI policy? Unlike the Latin American NIES they could not rely in the export of primary goods to obtain foreign exchange ; the American aid, that allowed them to follow an ISI policy in the 1950's, were also drying out.⁵ There was a need to generate foreign exchange, a need to move to an EOI stage. The Asian NIES governments could implement a change of economic policy from ISI to EOI because there was no opposition from internal market oriented industrialists. Labor-intensive industries were encouraged because there was no opposition from the labor unions.

The non-existence natural of resources have enabled them to avoid the overvaluation of their currencies (the appearance of the "Dutch disease" as in the Latin American NIES).⁶ Also they maintained a consistent scheme of subsidies and incentives for exportable goods.

In the Asian NIES the role of the TNCs have been a minor one in their economic development. The government controlled it. They were directed to the generation of exports. The establishment of Export Processing Zones testifies to this argument. When directed to import substitution industries, they were not allowed a 100% ownership. In all cases joint ventures were encouraged.

In the 1970's an ISI of capital-intensive goods were implemented. Specially in Korea, the government encouraged the domestic industrialists to undertake the production of large scale capital-intensive projects. Even the government stepped in this process. Even so a discriminate protectionism was adopted. Korea undertook massive foreign borrowing mostly used to finance productive investment that produce exports that can service the external debt. Since the 1980's these countries are adjusting to the new economic environment. With no more cheap labor force available now, they are moving to the export of capital-intensive goods.

III. Conclusions

The poor economic performance of the Latin American NIES, as a result of the adoption of an indiscriminate ISI policy, has been due to the constraints posed by the existences of pressure groups. It is ironic that the main beneficiaries of the industrialization process have been the TNCs and not the domestic industrialists. The ISI policy was designed to foster domestic infant industries, but these infant industries were not fostered.

The Asian NIES good economic performance shows that a combination of EOI and discriminate ISI policy can work. There is no contradiction between these two models of industrialization. Also it shows that to undertake this policy strong governments that carry out the elimination of pressure groups are needed.

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Notes:

1. CEPD Taiwan Republic of China "Economic Development" 1988 Council for Economic Planning and Development.
2. Anglade, Christian and Fortin, Carlos (eds) "The State and Capital Accumulation in Latin America" Volume 2 Mcmillan Press 1990 See specially Chapter 8.
3. IDE "A comparative Study on Economic Development between Asia and Latin America" Institute of Developing Economies JRP Series N#43 1987
4. Jenkins, Rhys "Transnational Corporations and the Latin American Automobile Industry" 1987
5. Mason, Edward S. Editor "The Economic and Social Modernization of the Republic of Korea" Harvard University Press 1980
6. Bradford, Colin "NICs and the Next-Tier NICs as Transitional Economies" in "Trade and Structural Change in Pacific Asia" Edit. by Bradford, Colin NBER 1987

General Indicators

	<u>Area</u>	<u>Populat.</u>	<u>GDP</u>			
	(1,000km ²)	(mill-mid.1989)	(average annual growth rate)			
			1965-1980	1980-87	1988	1989
Brazil	8,512	147.4	9.0	3.3	-0.3	3.0
Mexico	1,972	86.7	6.5	0.5	1.1	3.0
Korea	98	42.2	9.5	8.6	12.2	6.1
Taiwan	36	20.0	9.8	7.6	7.8	7.7

	<u>Exports</u>	<u>Imports</u>	<u>Inflat. rate</u>
	(mill. of US dollars)		(per cent)
	1989		1989
Brazil	34392	20022	1476.1
Mexico	22700	22900	18.2
Korea	62331	61300	5.6
Taiwan	66198	52256	4.4

Sources:

—World Development Report 1989 World Bank

—Taiwan Statistical Data Book 1989

CEPD Republic of China

—Statistical Yearbook for Latin America and the Caribbean 1989

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